Internal Revenue bulletin

Bulletin No. 2004-24
June 14, 2004

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2004–56, page 1055.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning July 1, 2004, will be 4 percent for overpayments (3 percent in the case of a corporation), 4 percent for underpayments, and 6 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 will be 1.5 percent.

Rev. Rul. 2004–58, page 1043.

Preproduction costs of creative property. This ruling provides that a taxpayer may not deduct as a loss under section 165 of the Code the costs of acquiring and developing creative property if the taxpayer does not establish an intention to abandon the property and an affirmative act of abandonment, or an identifiable event evidencing a closed and completed transaction establishing the worthlessness of the property.

Rev. Rul. 2004–59, page 1050.

State law conversion from partnership to corporation. This ruling explains the federal tax consequences when an entity classified as a partnership for federal tax purposes converts into a state law corporation under a state statute that does not require an actual transfer of the unincorporated entity's assets or interests.

T.D. 9127, page 1042.

Final and temporary regulations under section 108 of the Code clarify that if a taxpayer realizes excluded COD income either during or after the taxable year in which the taxpayer is the distributor or transferor of assets for a transaction described in section 381(a), those attributes to which the acquiring corporation succeeds, including the basis of property, must reflect the reductions required by section 108(b).

T.D. 9129, page 1046.
REG–148399–02, page 1066.

Final, temporary, and proposed regulations under section 263A of the Code except interest expense incurred by a lessor in certain safe harbor leasing transactions from the requirement to capitalize interest under section 263A.

EMPLOYEE PLANS

Rev. Rul. 2004–57, page 1048.

Governmental plan; union; section 457(b). This ruling holds that a deferred compensation plan does not fail to be an eligible governmental plan under section 457(b) of the Code merely because the plan is created, offered, and administered by a union, provided adoption of the plan meets certain criteria set forth in the ruling.

Announcement 2004–52, page 1071.

Correction; section 457; Rev. Rul. 2004–57. A transition rule is set forth for a plan established before June 14, 2004, that does not satisfy the requirements of Rev. Rul. 2004–57 solely as a result of being established and maintained by a labor organization instead of being established and maintained by an eligible governmental employer.

(Continued on the next page)

Announcements of Disbarments and Suspensions begin on page 1067.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

EMPLOYMENT TAX

Rev. Rul. 2004–60, page 1051.
Federal Insurance Contributions Act (FICA); options and deferred compensation transfer on divorce. This ruling concludes that nonqualified stock options and nonqualified deferred compensation transferred by an employee to a former spouse incident to a divorce are subject to the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and income tax withholding to the same extent as if retained by the employee. The ruling also provides reporting requirements applicable to the wage payments. Notice 2002–31 modified.

TAX CONVENTIONS

Announcement 2004–54, page 1061.
This announcement provides the rates for various types of income under a new income tax treaty with Japan. For purposes of withholding, the treaty is generally effective July 1, 2004. The tables in this announcement can be used, depending on the effective dates, to replace the entries for Japan in Tables 1 and 2 in Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities (For Withholding in 2004).*

ADMINISTRATIVE

Rev. Proc. 2004–36, page 1063.
This procedure provides a safe harbor method of accounting that allows film producers to amortize certain creative property costs ratably over a period of 15 years beginning in the year the creative property costs are written off for book purposes under AICPA Statement of Position (SOP) 00–2, "Accounting for Producers or Distributors of Film." Rev. Proc. 2002–9 modified and amplified.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 108.—Income From Discharge of Indebtedness

26 CFR 1.108–7: Reduction of attributes.

T.D. 9127

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Reduction of Tax Attributes Due to Discharge of Indebtedness

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations regarding the reduction of tax attributes under sections 108 and 1017 of the Internal Revenue Code. These final regulations affect taxpayers that realize income from the discharge of indebtedness that is excluded from gross income pursuant to section 108.

DATES: *Effective Date*: These final regulations are effective May 10, 2004.

Applicability Date: These final regulations apply to discharges of indebtedness occurring on or after May 10, 2004.

FOR FURTHER INFORMATION CONTACT: Theresa M. Kolish, (202) 622–7530, of the Office of Associate Chief Counsel (Corporate) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

On July 18, 2003, the IRS and Treasury Department promulgated temporary regulations providing guidance regarding the application of the attribute reduction rules of sections 108 and 1017. Those temporary regulations clarified that, in the case of a transaction described in section 381(a) that ends a year in which the distributor or transferor corporation excludes income from the discharge of indebtedness from gross income under section 108(a) (excluded COD income), any tax attributes to which the acquiring corporation succeeds, including the basis of property acquired by the acquiring corporation in the transaction, must reflect the reductions required by sections 108 and 1017. For this purpose, all attributes listed in section 108(b)(2) of the distributor or transferor corporation immediately prior to the transaction described in section 381(a), including the basis of property, but after the determination of tax for the year of the discharge, are available for reduction under section 108(b)(2).

The temporary regulations (T.D. 9080, 2003–40 I.R.B. 696) were published in the **Federal Register** (68 FR 42590) for July 18, 2003, and a notice of proposed rulemaking (REG–113112–03, 2003–40 I.R.B. 761) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (68 FR 42652). No public hearing was requested or held. One written comment was received. The following paragraphs describe the written comment received and the changes made to the temporary regulations in these final regulations.

The comment received argued that the rules of the temporary regulations are contrary to the relevant provisions of the Internal Revenue Code. The IRS and Treasury Department continue to believe that the rules of sections 108(b)(4)(A) and 1017 merely prescribe an ordering of calculations and that the rules of the temporary regulations are consistent with the policies underlying sections 108 and 1017 and the corporate reorganization provisions, including "deferring, but eventually collecting within a reasonable period, tax on ordinary income realized from debt discharge." S. Rep. No. 96–1035, at 10 (1980).

The IRS and Treasury Department, however, have become aware that taxpayers are taking the position that the rules of the temporary regulations do not apply in certain cases to reduce the attributes to which the acquiring corporation succeeded as a result of certain transactions described in section 381(a). Therefore, these final regulations make certain modifications to the rules of the temporary regulations to ensure that, to the extent possible, the transferor corporation's excluded COD income is applied to reduce attributes in a manner that will effect a deferral, rather than a permanent elimination, of income. In that regard, the final regulations apply in cases in which the taxpayer realizes excluded COD income either during or after the taxable year in which the taxpayer is the distributor or transferor of assets in a transaction described in section 381(a). In addition, it provides that the basis of stock or securities of the acquiring corporation received by the taxpayer in exchange for the transferred assets in the transaction described in section 381(a) is not available for reduction under section 108(b)(2).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Theresa M. Kolish, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Final Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for "1.108–7T" and continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.108–7T is redesignated as §1.108–7 and amended as follows:

1. The language "(temporary)" is removed from the section heading.

2. Paragraphs (c) and (e) are revised.

The revisions read as follows:

§1.108–7 Reduction of attributes.

* * * * *

(c) *Transactions to which section 381 applies*. If a taxpayer realizes COD income that is excluded from gross income under section 108(a) either during or after a taxable year in which the taxpayer is the distributor or transferor of assets in a transaction described in section 381(a), any tax attributes to which the acquiring corporation succeeds, including the basis of property acquired by the acquiring corporation in the transaction, must reflect the reductions required by section 108(b). For this purpose, all attributes listed in section 108(b)(2) immediately prior to the transaction described in section 381(a), but after the determination of tax for the year of the distribution or transfer of assets, including basis of property, will be available for reduction under section 108(b)(2). However, the basis of stock or securities of the acquiring corporation, if any, received by the taxpayer in exchange for the transferred assets shall not be available for reduction under section 108(b)(2).

* * * * *

(e) *Effective date*. This section applies to discharges of indebtedness occurring on or after May 10, 2004.

Par. 3. Section 1.1017–1 is amended by revising paragraph (b)(4) to read as follows:

§1.1017–1 Basis reductions following a discharge of indebtedness.

* * * * *

(b) * * *

(4) *Transactions to which section 381 applies*. If a taxpayer realizes COD income that is excluded from gross income under section 108(a) either during or after a taxable year in which the taxpayer is the distributor or transferor of assets in a transaction described in section 381(a), the basis of property acquired by the acquiring corporation in the transaction must reflect the reductions required by section 1017 and this section. For this purpose, the basis of property of the distributor or transferor corporation immediately prior to the transaction described in section 381(a), but after the determination of tax for the year of the distribution or transfer of assets, will be available for reduction under section 108(b)(2). However, the basis of stock or securities of the acquiring corporation, if any, received by the taxpayer in exchange for the transferred assets shall not be available for reduction under section 108(b)(2). See §1.108–7. This paragraph (b)(4) applies to discharges of indebtedness occurring on or after May 10, 2004.

Par. 4. In section §1.1017–1T, paragraph (b)(4) is removed.

§1.1017–1T Basis reductions following a discharge of indebtedness (temporary).

Paragraphs (a) through (b)(4) [Reserved]. For further guidance, see §1.1017–(a) through (b)(4).

* * * * *

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved May 4, 2004.

Gregory F. Jenner,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 10, 2004, 8:45 a.m., and published in the issue of the Federal Register for May 11, 2004, 69 F.R. 26038)

Section 165.—Losses

26 CFR 1.165–1: Losses.
(Also § 1.165–2.)

Preproduction costs of creative property. This ruling provides that a taxpayer may not deduct as a loss under section 165 of the Code the costs of acquiring and developing creative property if the taxpayer does not establish an intention to abandon the property and an affirmative act of abandonment, or an identifiable event evidencing a closed and completed transaction establishing the worthlessness of the property.

Rev. Rul. 2004–58

ISSUE

May a taxpayer deduct the cost of acquiring and developing creative property as a loss under § 165(a) of the Internal Revenue Code in the situations described below?

FACTS

X is a corporation that files returns on a calendar year basis for federal income tax purposes. *X* is engaged in the trade or business of producing motion pictures. As part of that trade or business, *X* routinely incurs costs to acquire and develop creative property such as screenplays, scripts, treatments, story outlines, motion picture production rights to books, plays, and other literary works, and similar property for purposes of potential development, production, and exploitation. The type of rights *X* acquires in creative property varies from property to property and may include exclusive rights of ownership or limited exploitation rights, and may include rights for the entire remaining copyright term of the property or rights for a limited period of time.

X ultimately sets for production only a small percentage of the creative property that *X* acquires. Most of the creative property that *X* sets for production is set within three years of *X*'s acquisition of the property. However, *X* does set some property for production that *X* has held for longer than three years. Additionally, *X* may sell to a third party *X*'s rights to a creative property not set for production. *X* does not discard, release to the public domain, or otherwise dispose of the creative properties not set for production or sold. Generally these properties are retained indefinitely.

In order to preserve the properties in a condition that allows for future use, *X* maintains facilities for storing creative property retained but not set for production. *X* retains these properties for various reasons, including, but not limited to, the following:

1. To exercise X's ownership or other contractual rights at any time in the future by, among other things,

a. selling or setting a property for production if, for example, the subject matter becomes more popular or the writer becomes well known;

b. preventing or defending against a possible future copyright infringement lawsuit; and

c. keeping competitors from developing the property; and

2. To maintain good relations with the seller of the property.

For financial accounting purposes, *X* applies generally accepted accounting principles (GAAP) to the cost of acquiring and developing creative property. For creative property that has not been set for production, *X* recognizes a loss for financial accounting purposes in the earliest of: (1) the year in which *X* decides not to set the property for production; (2) the year in which *X* sells or otherwise disposes of the property; or (3) the third year following the year in which *X* acquires the property.

Situation 1

In 2003, *X* purchases the exclusive rights for the remainder of the copyright term to script *a*. In 2004, an *X* executive decides that *X* will not set script *a* for production. In accordance with *X*'s financial accounting practice, in 2004 *X* writes off for financial accounting purposes the cost of acquiring and developing script *a*. Although *X* writes off the cost of script *a* for financial accounting purposes and does not set script *a* for production, *X* retains all rights to script *a* indefinitely.

Situation 2

In 2003, *X* purchases limited exploitation rights to use screenplay *b* in the production of a motion picture. Under the terms of the purchase agreement, all of *X*'s rights in screenplay *b* expire if screenplay *b* is not set for production within four years from the date of the agreement. *X* executives do not make a specific decision not to set screenplay *b* for production, but screenplay *b* is not set for production by the time *X*'s rights in screenplay *b* expire in 2007. In accordance with *X*'s financial accounting practice, in 2006 *X* writes off for financial accounting purposes the cost of acquiring and developing screenplay *b*. Although *X* writes off the cost of screenplay *b* for financial accounting purposes and does not set screenplay *b* for production, *X* continues to retain exploitation rights to screenplay *b* until 2007, at which time those rights expire. *X* does not attempt to renew, extend, or otherwise reacquire any rights to screenplay *b*.

Situation 3

In 2003, *X* purchases motion picture rights *c*, the exclusive rights to produce motion pictures based on a particular novel, from *A*, the author of the novel. Under the terms of the contract, *A* has an option to reacquire motion picture rights *c* if *X* does not set them for production within two years of acquisition. In 2005, *X* decides not to set motion picture rights *c* for production in the foreseeable future. *X* informs *A* that *A* has the right to reacquire the rights pursuant to the option. *A* contacts other studios to determine if they are interested in acquiring motion picture rights *c*, but is unable to find another studio to purchase the rights for a satisfactory price. Therefore, *A* declines to exercise the option. In accordance with *X*'s financial accounting practice, in 2005 *X* writes off for financial accounting purposes the cost of acquiring and developing motion picture rights *c*. *X* retains motion picture rights *c* indefinitely.

LAW AND ANALYSIS

Section 165(a) allows a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise. Section 165(b) states that the amount of the deduction for a loss is the adjusted basis as provided in § 1011. *See also* § 1.165–1(c) of the Income Tax Regulations.

Section 1.165–1(b) provides that, to be allowable as a deduction under § 165(a), a loss must be evidenced by a closed and completed transaction, fixed by an identifiable event, and, except as provided in § 165(h) and § 1.165–11, actually sustained during the taxable year. Section 1.165–1(d)(1) provides that a loss is treated as sustained during the taxable year in which the loss occurs, as evidenced by a closed and completed transaction, and as fixed by an identifiable event occurring in such taxable year.

Section 1.165–2(a) allows a deduction under § 165(a) for a loss incurred in a business or in a transaction entered into for profit and arising from the sudden termination of the usefulness in such business or transaction of any nondepreciable property, when such business or transaction is discontinued or when such property is permanently discarded from use therein. Section 1.165–2(a) further provides that the taxable year in which a loss is sustained is not necessarily the taxable year in which the overt act of abandonment, or the loss of title to the property, occurs.

Section 165 losses have been referred to as abandonment losses to reflect that some act is required that evidences a taxpayer's intent to permanently discard or discontinue use. *Gulf Oil Corp. v. Commissioner*, 914 F.2d 396, 402 (3d Cir. 1990). To establish the abandonment of an asset for purposes of § 165, a taxpayer must show both (1) an intention to abandon the asset, and (2) an affirmative act of abandonment. *A.J. Indus., Inc. v. United States*, 503 F.2d 660, 670 (9th Cir. 1974); *CRST, Inc. v. Commissioner*, 92 T.C. 1249, 1257 (1989), *aff'd*, 909 F.2d 1146 (8th Cir. 1990); Rev. Rul. 93–80, 1993–2 C.B. 239. A deduction is not allowable if a taxpayer intends to hold and preserve property for possible future use or to realize potential future value from the property. *A.J. Indus.*, 503 F.2d at 670. Abandonment of an intangible property interest should be accompanied by some express manifestation. *Citron v. Commissioner*, 97 T.C. 200, 209 (1991). *See also Echols v. Commissioner*, 935 F.2d 703, 706–08 (5*th* Cir. 1991) (finding both an intent to abandon and an affirmative act of abandonment when taxpayers called a partnership meeting at which they tendered their 75% partnership interest to another partner, or anyone else, "*gratis*," and announced that they would contribute no further funds to the partnership), *reh'g denied*, 950 F.2d 209 (5th Cir. 1991).

The "identifiable event" required by § 1.165–1(b) and (d)(1) "must be observable to outsiders and constitute 'some step which irrevocably cuts ties to the asset.'" *United Dairy Farmers, Inc. v. U.S.*, 267 F.3d 510, 522 (6th Cir. 2001) (quoting *Corra Resources, Ltd. v. Commissioner*, 945 F.2d 224, 226 (7th Cir. 1991)). Mere non-use of an asset is not sufficient to establish an act of abandonment. *Standley v. Commissioner*, 99 T.C. 259, 272 (1992), *aff'd without published opinion*, 24 F.3d 249 (9th Cir. 1994); *Jones Beach Theatre Corp. v. Commissioner*, T.C.M. 1966–100. Similarly, internal communications or decisions within a taxpayer's organization are not sufficient affirmative acts of abandonment. *See Corra Resources*, 945 F.2d at 226.

A taxpayer need not relinquish legal title to property in all cases to establish abandonment, provided there is an intent to abandon and an affirmative act of abandonment. *See Echols*, 935 F.2d at 706; *Middleton v. Commissioner*, 77 T.C. 310, 322 (1981), *aff'd per curiam*, 693 F.2d 124 (11th Cir. 1982). Retention of bare legal title to property does not preclude a deduction under § 165(a) in certain cases in which property has become worthless. *See Helvering v. Gordon*, 134 F.2d 685, 689 (4th Cir. 1943), *acq.*, 1951–1 C.B. 2; *Rhodes v. Commissioner*, 100 F.2d 966, 970 (6th Cir. 1939); Rev. Rul. 54–581, 1954–2 C.B. 112. In such cases the courts have adopted the rule that a taxpayer may claim a loss on property without being required to divest legal title if the taxpayer does not intend to hold the property and the taxpayer proves by identifiable events that the property has become worthless. *A.J. Indus.*, 503 F.2d at 670. The taxpayer's conduct in regarding the property as worthless and not intending to preserve or hold it may be the practical equivalent of abandonment. *See id.; Lockwood v. Commissioner*, 94 TC 252, 258 (1990) (leaving master recordings on a closet shelf instead of storing in a necessary climate-controlled environment was tantamount to throwing them in the trash).

A deduction for worthlessness under § 165 is allowable only if there is a closed and completed transaction fixed by identifiable events establishing that the property is worthless in the taxable year for which the deduction is claimed. § 1.165–1(b) and (d)(1). Although the taxpayer is not required to be an "incorrigible optimist," *United States v. S.S. White Dental Manufacturing Co.*, 274 U.S. 398, 403 (1927), a mere diminution in the value of an asset is not sufficient to establish worthlessness. *Proesel v. Commissioner*, 77 T.C. 992, 1006 (1981). Assets may not be considered worthless, even when they have no liquidated value, if there is a reasonable hope and expectation that they will become valuable in the future. *See Lawson v. Commissioner*, 42 B.T.A. 1103, 1108 (1940); *Morton v. Commissioner*, 38 B.T.A. 1270, 1278 (1938), *aff'd*, 112 F.2d 320 (7th Cir. 1940); Rev. Rul. 77–17, 1977–1 C.B. 44.

Abandonment and other transactions that divest the taxpayer's title are identifiable events that support a closed and completed transaction. Additionally, identifiable events may include "other acts or events which reflect the fact that the property is worthless." *Proesel*, 77 T.C. at 1005. To the extent that the transactions do not include divestitures of title or abandonment, the essential element for tax purposes is that a particular event destroyed the potential value and usefulness of the asset to the taxpayer. *See Echols*, 950 F.2d at 213 (partnership's insolvency, third party developer's default, and inability of partners to restructure the underlying debt were identifiable events that evidenced worthlessness); *Corra Resources*, 945 F.2d at 226–27 (loss realized in the year in which coal mining lease expired); *George Freitas Dairy, Inc. v. United States*, 582 F.2d 500, 502 (9th Cir. 1978) (cancellation of production quota contract was identifiable event that evidenced the closed and completed transaction); *Proesel*, 77 T.C. at 998–99, 1006–07 (finding insufficient evidence of worthlessness despite unsuccessful attempts to sell or find distributor for a motion picture by contacting all major studios and major independent distributors; however, contract to produce the motion picture could have been found worthless upon settled litigation with respect to breach of contract or demonstration that litigation would be fruitless); *Oak Harbor Freight Lines, Inc. v. Commissioner*, T.C.M. 1999–291 (an act of Congress rendered motor carrier authorities worthless because all rights associated with the authorities were eliminated); *Springfield Productions, Inc. v. Commissioner*, T.C.M. 1979–23 (testimony by taxpayer's president that film was worthless because taxpayer had unsuccessfully submitted it for sale or distribution to all major studios and small distribution companies was not substantial proof of worthlessness); *Golden State Towel and Linen Service, Ltd. v. United States*, 179 Ct. Cl. 300, 310 (1967) (finding that it is only when all or a substantial, identifiable, vendible portion of a customer list is terminated permanently, either through extraneous causes or the sudden and involuntary inability of the owner to serve them, that a tax loss may be claimed, and then only if the loss may be adequately measured.)

A taxpayer's treatment of the costs of acquiring property for financial accounting purposes does not control the treatment of those costs for federal income tax purposes. *See Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 542–44 (1979).

X has not performed an affirmative act of abandoning creative property merely because: (1) an *X* executive decides not to actively pursue the development or production of the property, *see Corra Resources*, 945 F.2d at 226; (2) *X* does not set the property for production within three taxable years of acquiring that property (notwithstanding that it is unlikely that *X* will ever set for production property that *X* retains for three years or more), *see Standley*, 99 T.C. at 272; and (3) *X* writes off for financial accounting purposes the cost of acquiring and developing the property, *see Thor Power Tool*, 439 U.S. at 542–44. Although the above facts may be relevant factors to consider, an affirmative act to abandon must be ascertained from all the facts and surrounding circumstances, *Citron*, 97 T.C. at 210. *X* retains creative properties for potential future exercise of ownership or other contractual rights, whether by sale or use, or to enforce those rights by preventing *X*'s competitors from using the property. In fact, *X* does sell or set for production some creative property after writing off the costs of such property for financial accounting purposes and having made a decision not to set the property for production. These facts are inconsistent with an intent to permanently abandon property and with an affirmative act of abandonment, both of which are required for an abandonment loss deduction under § 165(a).

Furthermore, *X* is not entitled to a worthlessness deduction in the absence of evidence of a closed and completed transaction fixed by an identifiable event establishing worthlessness. A creative property that *X* acquires may not be presumed worthless simply because *X* does not set that property for production, either by a specific internal decision or by inaction, as these are not identifiable events that irrevocably cut ties to the asset. *See Corra Resources*, 945 F.2d at 226. In addition, the facts indicate that the creative properties that *X* retains after writing off their costs for financial accounting purposes are not worthless to *X*. *X* maintains proper storage facilities for the properties, thereby preserving the properties in a condition that allows for future exercise of ownership or other contractual rights. By retaining its rights in a property, *X* can prevent a competitor from exploiting that property or prevent or defend against potential copyright infringement lawsuits. In some cases, *X* retains creative property to maintain good relations with the seller from whom *X* acquired the property. Finally, *X* retains some property in the hope that the property will have future value if the subject matter becomes more popular, if the writer becomes better known, or for various other reasons. These facts indicate that *X* has an intention to hold and preserve property because of a *bona fide* belief that the property has value due to the possibility that the property will be of future use. Thus, without an identifiable event that destroys the potential value and usefulness of the property to *X*, the property may not be considered worthless.

In *Situation 1*, an *X* executive's decision in 2004 not to set script *a* for production, the write-off for financial accounting purposes, and the fact that the script has not been set for production by the end of 2004 do not constitute affirmative acts of abandonment of script *a* for purposes of § 165(a), nor are they identifiable events evidencing a closed and completed transaction establishing worthlessness. To the contrary, *X*'s retention of script *a* in order to keep the potential to exercise ownership or other contractual rights in the future is evidence that the script is not worthless. Thus, in the absence of any affirmative act of abandonment or showing of worthlessness in 2004, *X* may not deduct in that year as a loss under § 165(a) the cost of acquiring and developing script *a*.

In *Situation 2*, the facts do not indicate an affirmative act of abandonment or identifiable events evidencing a closed and completed transaction establishing worthlessness until 2007. *X* may deduct *X*'s adjusted basis in screenplay *b* under § 165(a) in 2007 because *X*'s rights to screenplay *b* expire in that year. *See* Rev. Rul. 81–160, 1981–1 C.B. 312. In the absence of any affirmative act of abandonment or showing of worthlessness in an earlier taxable year, *X* may not deduct in any earlier taxable year as a loss under § 165(a) the cost of acquiring and developing screenplay *b*.

In *Situation 3*, the facts do not indicate an affirmative act of abandonment or identifiable events evidencing a closed and completed transaction establishing worthlessness. *X*'s notification to *A* of *A*'s right to reacquire motion picture rights *c* pursuant to the contract between *X* and *A* does not constitute an affirmative act of abandonment by *X* of motion picture rights *c* for purposes of § 165(a). Rather, *X* is merely complying with its contractual obligations. When *A* declines to exercise its option, *X* continues to retain motion picture rights *c* in order to keep the potential to exercise its ownership or other contractual rights in the future. Furthermore, *A*'s failure to exercise the option to reacquire motion picture rights *c* does not establish that those rights are worthless in 2005. That *A* was unable to find another studio to purchase motion picture rights *c* at a satisfactory price is also insufficient to establish the worthlessness of motion picture rights *c* in 2005. *See Proesel*, 77 T.C. at 998–99, 1006–07. Neither of these acts is an identifiable event establishing that motion picture rights *c* are valueless in 2005 and without reasonable expectation of future value. *X*'s retention of motion picture rights *c* in order to keep the potential to exercise ownership or other contractual rights in the future is evidence that the script is not worthless. Thus, in the absence of any affirmative act of abandonment or showing of worthlessness in 2005, *X* may not deduct in that year as a loss under § 165(a) the cost of acquiring and developing motion picture rights *c*.

HOLDING

A taxpayer may not deduct the costs of acquiring and developing creative property as a loss under § 165(a) if the taxpayer does not establish an intention to abandon the property and an affirmative act of abandonment, or identifiable event(s) evidencing a closed and completed transaction establishing worthlessness.

DRAFTING INFORMATION

The principal author of this revenue ruling is Joy Spies of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Ms. Spies at (202) 622–5020 (not a toll-free call).

Section 263A.—Capitalization and Inclusion in Inventory Costs of Certain Expenses

26 CFR 1.263A–9: The avoided cost method.

T.D. 9129

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Uniform Capitalization of Interest Expense in Safe Harbor Sale and Leaseback Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains regulations relating to the capitalization of interest expense incurred in sale and leaseback transactions under the Economic Recovery Tax Act of 1981 (ERTA) safe harbor leasing provisions. The regulations affect taxpayers that provide purchase money obligations in connection with these transactions. The text of the temporary regulations also serves as the text of the proposed regulations (REG–148399–02) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin. The final regulations consist of technical revisions to reflect the issuance of the temporary regulations.

DATES: *Effective Date*: These regulations are effective May 20, 2004.

Applicability Dates: For dates of applicability, see §1.263A–15T(a)(3).

FOR FURTHER INFORMATION CONTACT: Grant Anderson, 202–622–4930 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1 under section 263A(f) of the Internal Revenue Code (Code) relating to the treatment of certain interest expense incurred by the lessor in a sale and leaseback transaction under the ERTA safe harbor leasing provisions (former section 168(f)(8), as enacted by section 201(a) of ERTA, Public Law 97–34, 95 Stat. 214).

Section 263A (the uniform capitalization rules) generally requires the capitalization of direct costs and indirect costs properly allocable to real property and tangible personal property produced by a taxpayer.

Section 263A(f) and the regulations thereunder provide special rules for capitalizing interest to property produced by a taxpayer. In general, section 263A(f) only requires the capitalization of interest that is paid or incurred during the production period of certain property (referred to as designated property). Designated property includes all real property and certain tangible personal property. See §1.263A–8(b) of the Income Tax Regulations.

In general, interest incurred on debt that is directly attributable to production expenditures with respect to designated property (traced debt) is capitalized first. See section 263A(f)(2)(A)(i). If production expenditures with respect to designated property exceed the amount of traced debt, interest on any other debt of the taxpayer is capitalized to the extent that the interest could have been reduced if production expenditures had not been incurred. See section 263A(f)(2)(A)(ii). The amount of interest required to be capitalized under section 263A(f) is calculated by reference to eligible debt. See §1.263A–9(a)(4). Eligible debt generally includes all outstanding debt of the taxpayer. Certain types of debt (listed in paragraphs (i) to (viii) of § 1.263A–9(a)(4)), however, are excluded from the definition of eligible debt.

The ERTA safe harbor leasing provisions were intended to permit owners of property to transfer the tax benefits of ownership (depreciation and the investment credit) to other persons. The ERTA safe harbor leasing provisions operate by guaranteeing that, for federal tax purposes, (i) a transaction meeting certain stated qualifications (a qualifying transaction) will be treated as a lease even though the qualifying transaction otherwise would not be considered a lease, and (ii) the nominal lessor will be treated as the owner of the property even though the nominal lessee is in substance the owner of the property.

Regulations issued under the ERTA safe harbor leasing provisions clarify that a qualifying transaction may be part of a sale and leaseback transaction, in which the nominal lessee sells the underlying property for Federal tax purposes to the nominal lessor for a cash payment and an interest bearing note (purchase money note), and the nominal lessor simultaneously leases the property back to the nominal lessee. See §5c.168(f)(8)–1(e) *Example 2*. Generally, the nominal lessor deducts, and the nominal lessee includes in income, the interest accruing on the purchase money note, subject to certain limitations. See §5c.168(f)(8)–7.

Explanation of Provisions

The temporary regulations provide that eligible debt under section 263A(f) does not include a purchase money obligation given by the lessor to the lessee (or a party related to the lessee) in a sale and leaseback transaction under former section 168(f)(8) as enacted by ERTA. Accordingly, these obligations are excluded from the definition of eligible debt, and the interest accruing on the obligations is not subject to capitalization with respect to designated property under section 263A(f).

The temporary regulations apply to interest incurred in taxable years beginning on or after May 20, 2004, except that, in the case of property that is inventory in the hands of the taxpayer, the temporary regulations apply to taxable years beginning on or after May 20, 2004. However, taxpayers may elect to apply the temporary regulations to interest incurred in taxable years beginning on or after January 1, 1995, or, in the case of property that is inventory in the hands of the taxpayer, to taxable years beginning on or after January 1, 1995 (the general effective date of the interest capitalization regulations).

For purposes of §1.263A–15(a)(2), the exclusion of purchase money obligations given by the lessor to the lessee (or a party related to the lessee) in a sale and leaseback transaction under former section 168(f)(8) as enacted by ERTA will be considered to be a reasonable position for the application of section 263A(f) in taxable years beginning before January 1, 1995. Consequently, a taxpayer changing a method of accounting for property that is not inventory in the hands of the taxpayer to conform to the temporary regulations may elect to include interest incurred after December 31, 1986, in taxable years beginning on or after December 31, 1986 (the general effective date of section 263A), and before January 1, 1995, in the determination of its adjustment under section 481(a). A taxpayer changing a method of accounting for property that is inventory in the hands of the taxpayer to conform to the temporary regulations must revalue its beginning inventory in the year of change as if the new method of accounting had been in effect during all prior years.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Please refer to the cross-referenced notice of proposed rulemaking published elsewhere in this issue of the Bulletin for applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Grant Anderson of the Office of

Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.263A–9 is amended by revising paragraphs (a)(4)(vii), and (viii) and adding paragraph (a)(4)(ix) to read as follows:

§1.263A–9 The avoided cost method.

(a) * * *

(4) * * *

(vii) Reserves, deferred tax liabilities, and similar items that are not treated as debt for Federal income tax purposes, regardless of the extent to which the taxpayer's applicable financial accounting or other regulatory reporting principles require or support treating these items as debt;

(viii) Federal, State, and local income tax liabilities, deferred tax liabilities under section 453A, and hypothetical tax liabilities under the look-back method of section 460(b) or similar provisions; and

(ix) [Reserved]. For further guidance, see §1.263A–9T(a)(4)(ix).

* * * * *

Par. 3. Section 1.263A–9T is added to read as follows:

§1.263A–9T The avoided cost method (temporary).

(a)(1) through (3) [Reserved]. For further guidance, see §1.263A–9(a)(1) through (3).

(4) *Definition of eligible debt*. Except as provided in this paragraph (a)(4), *eligible debt* includes all outstanding debt (as evidenced by a contract, bond, debenture, note, certificate, or other evidence of indebtedness). Eligible debt does not include—

(i) through (viii) [Reserved]. For further guidance, see §1.263A–9(a)(4)(i) through (viii).

(ix) A purchase money obligation given by the lessor to the lessee (or a party that is related to the lessee) in a sale and leaseback transaction involving an agreement qualifying as a lease under §5c.168(f)(8)–1 through §5c.168(f)(8)–11 of this chapter. See §5c.168(f)(8)–1(e) *Example (2)* of this chapter.

(b) through (g) [Reserved]. For further guidance, see §1.263A–9(b) through (g).

Par. 4. Section 1.263A–15T is added to read as follows:

§1.263A–15T Effective dates, transitional rules, and anti-abuse rule (temporary).

(a)(1) and (2) [Reserved]. For further guidance, see §1.263A–15(a)(1) and (2).

(3) Section 1.263A–9T applies to interest incurred in taxable years beginning on or after May 20, 2004, except that, in the case of property that is inventory in the hands of the taxpayer, §1.263A–9T applies to taxable years beginning on or after May 20, 2004. However, taxpayers may elect to apply §1.263A–9T to interest incurred in taxable years beginning on or after January 1, 1995, or, in the case of property that is inventory in the hands of the taxpayer, to taxable years beginning on or after January 1, 1995. A change in a taxpayer's treatment of interest to a method consistent with §1.263A–9T is a change in method of accounting to which sections 446 and 481 apply.

(b) and (c) [Reserved]. For further guidance, see §1.263A–15(b) and (c).

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved May 10, 2004.

Gregory F. Jenner,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 19, 2004, 8:45 a.m., and published in the issue of the Federal Register for May 20, 2004, 69 F.R. 29066)

Section 457.—Deferred Compensation Plans of State and Local Governments and Tax-Exempt Organizations

26 CFR 1.457–2: Definitions.

Governmental plan; union; section 457(b). This ruling holds that a deferred compensation plan does not fail to be an eligible governmental plan under section 457(b) of the Code merely because the plan is created, offered, and administered by a union, provided adoption of the plan meets certain criteria set forth in the ruling.

Rev. Rul. 2004–57

ISSUE

Does a plan fail to be an eligible governmental plan under § 457(b) of the Internal Revenue Code solely because the plan is offered and administered by a labor union for the benefit of those State employees who are union members?

FACTS

An organization (including its local affiliates) that is a labor organization described in § 501(c)(5) (Union) represents professional firefighters employed by various city, municipal, and other local governments in State X ("Governmental Employers") under collective bargaining agreements between the Union and the Governmental Employers.

State X maintains an eligible governmental § 457(b) plan (Plan A). Plan A is available to employees of State X and employees of any political subdivision of State X, including both unionized and non-unionized public safety employees and civilians.

The Union would like to offer an additional eligible governmental § 457(b) plan (Plan B) that is available only to members of the collective bargaining units represented by the Union who are employed by the Governmental Employers.

Under Plan B, the members of the Union who are employees of the Governmental Employers that adopt Plan B are eligible to participate and elect to have the Governmental Employers make contributions on their behalf to Plan B out of their compensation from the Governmental Employers. Plan B states that the plan is established and maintained by the Governmental Employers and participants are informed of this. Only investments approved by the Union are offered under Plan B and amounts deferred by employees of Governmental Employers that adopt Plan B, plus any amounts transferred directly from any other eligible governmental § 457(b) plan, provide Plan B's exclusive source of funding.

Union members employed by Governmental Employers that do not adopt Plan B are not eligible to participate in Plan B, and no contributions may be made on their behalf regardless of whether their Governmental Employer is part of any collective bargaining agreement with the Union or its affiliates and regardless of whether the employees are union members. Employees of the Union are not eligible to participate in Plan B.

Plan B provides that all annual deferrals for a participant under the plan are combined with the participant's annual deferrals under Plan A and all other eligible plans of the same employer for purposes of the Plan B limitations designed to comply with the limitations of § 457(b), and are combined with annual deferrals under eligible plans of other employers to the extent information concerning such plans is provided by the participant. Thus, Plan B treats all deferrals under all eligible plans in which an individual participates by virtue of his or her relationship with a single employer as a single plan for purposes of determining whether deferrals in excess of the § 457(b) limitations have been made.

Because both Plan A and Plan B must comply with these limitations, they each include terms providing for correction of any excess deferrals under all plans. Plan B provides that if an excess deferral arises which is only an excess amount as a result of the combined annual deferrals under both Plan A and Plan B, then the excess amount will be corrected by Plan B (even though there would be no excess if only annual deferrals under Plan B were taken into account). By adoption of Plan B, each Governmental Employer agrees not only to forward payroll amounts representing annual deferrals under Plan B, but also to inform Plan B of the amount of the annual deferrals made under Plan A by participants in Plan A who also participate in Plan B and such other information known to the Governmental Employers as Plan B may need for proper administration. The adoption agreement also requires the Union to provide to the Governmental Employers such information from Plan B as the Governmental Employers may need to complete tax returns for their employees and to administer Plan A.

In addition, for purposes of Plan B's special catch-up contribution rules for participants who are within the three-year period ending before the year they reach normal retirement age, Plan B provides a normal retirement age which is the same as the normal retirement age under Plan A. Further, Plan B permits a plan-to-plan transfer of assets from Plan A (or any other eligible governmental plan) to Plan B for employees who have not had a separation from employment only if the following conditions are satisfied: (i) the transfer is from Plan A or any other plan that is an eligible governmental plan of State X; (ii) the transferring plan provides for the transfer; (iii) the participant whose deferred amounts are being transferred is performing services for a Governmental Employer that has adopted Plan B (and, for this purpose, Plan B treats the employer as the same employer only if the participant's compensation is paid by the same entity); and (iv) the participant or beneficiary whose amounts deferred are being transferred must have an amount deferred immediately after the transfer at least equal to the amount deferred with respect to that participant or beneficiary immediately before the transfer.

LAW AND ANALYSIS

Section 457 provides rules for the deferral of compensation by an individual participating in an eligible deferred compensation plan as defined in § 457(b). Section 457(b)(1) provides that the term "eligible deferred compensation plan" means a plan "established and maintained by an eligible employer" in which only individuals who perform services for the employer may be participants. The performance of services includes performance of services as an employee or as an independent contractor. Section 457(e)(2).

Section 457(e)(1) defines an "eligible employer" as (A) a State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State and (B) any other organization (other than a governmental unit) exempt under Subtitle A of the Internal Revenue Code. Section 1.457–2(e) of the Income Tax Regulations further defines the term "eligible employer" as including an entity that is a State that establishes a plan and § 1.457–2(l) provides that State means a State (treating the District of Columbia as a State as provided under § 7701(a)(10)), a political subdivision of a State, and any agency or instrumentality of a State.

Section 1.457–5(b) provides that for purposes of determining the amount of annual deferrals under a § 457 plan that are excluded from a participant's gross income in any taxable year, the participant's annual deferrals under all § 457 plans must be determined on an aggregate basis. For example, under § 1.457–5, all annual deferrals under all eligible plans (whether or not with the same employer) are combined for purposes of determining whether the limitations of § 457(b) have been exceeded. In this regard, § 1.457–4(e)(2) treats all deferrals under all eligible plans in which an individual participates by virtue of his or her relationship with a single employer as a single plan for purposes of determining excess deferrals.

Under § 1.457–10(b)(4), a plan-to-plan transfer from one eligible governmental plan to another eligible governmental plan of the same employer is permitted without a separation from employment if certain conditions are satisfied, including that the transfer is from an eligible governmental plan to another eligible governmental plan of the same employer (and, for this purpose, the employer is not treated as the same employer if the participant's compensation is paid by a different entity).

Section 457(g) provides that a plan maintained by an eligible governmental employer is not to be treated as an eligible deferred compensation plan unless all amounts of compensation deferred under the plan, all property and rights purchased with such deferred compensation amounts, and all income attributable to such amounts, property, or rights of the plan are held in trust for the exclusive benefit of participants and their beneficiaries. In order to be an eligible plan of a tax-exempt entity, § 457(b)(6) provides that the plan must be unfunded and plan assets must not be set aside for participants or their beneficiaries.

An arrangement does not fail to constitute a single eligible governmental plan for purposes of § 457(b) merely because the arrangement is funded through more than one trustee, custodian, or insurance carrier. See § 1.457–8 of the regulations and Notice 98–8, 1998–1 C.B. 355.

Under § 457, therefore, different rules apply depending on whether the entity establishing and maintaining the plan is a tax-exempt entity or a State government entity. A union that is a tax-exempt entity may establish and maintain an eligible § 457(b) plan, but only if the plan is unfunded and is for its employees or other individuals who perform services for the union. A State (including an agency or instrumentality thereof) may establish and maintain an eligible § 457(b) plan, but only if it is funded and only for employees of the State or other individuals who perform services for the State. A union may not establish and maintain a funded plan for its employees or for individuals who do not perform services for the union. However, an eligible governmental employer may adopt, for its collectively-bargained employees, a plan created by the union for employees of the governmental employer and offered and administered by the union, provided that the plan is "established and maintained by" the governmental employer. Thus, if the plan is established and maintained by a governmental employer, it can qualify as an eligible governmental § 457(b) plan, assuming that the plan satisfies all of the other requirements of § 457(b).

If the governmental employer has adopted the plan in a manner that reflects the employer as having established and maintained the plan, a plan does not fail to be an "eligible governmental § 457(b) plan" merely because the plan is created, offered and administered by a union even if it is in addition to another plan that is offered and administered by the governmental employer.

Under these facts, Plan B includes special provisions designed to comply with the rules for eligible governmental § 457 plans of the same employer, including coordination of limitations and corrections under § 1.457–5 and plan-to-plan transfer provisions that comply with § 1.457–10(b)(4). These facts are consistent with the plan being established and maintained by the Governmental Employers. The Union's involvement in administering the plan to be offered to employees of the Governmental Employers, such as coordinating the information necessary to determine whether any excess contributions are made for a participant and responsibility in providing information necessary for completing wage statements that reflect Plan B, is comparable to the involvement associated with a third party administrator who invests annual deferrals and administers the plan provisions for the employer. In this case, the Union is in effect administering Plan B for the Governmental Employers, as a plan that is established and maintained by the Governmental Employers as the actual employers of the union members.

HOLDING

Plan B does not fail to be an eligible governmental plan under § 457(b) solely because the plan is offered and administered by the Union, but only with respect to employees of the Governmental Employers that have adopted Plan B as described in these facts.

For § 457(b) plans that do not satisfy the requirements of this revenue ruling, see Announcement 2004–52, page 1071.

DRAFTING INFORMATION

The principal author of this revenue ruling is Vernon S. Carter of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling contact Vernon S. Carter at (202) 622–6060 (not a toll-free call).

Section 708.—Continuation of Partnership

26 CFR 1.708–1: Continuation of a partnership.
(Also: §§ 7701, 301.7701–1, 301.7701–2, 301.7701–3.)

State law conversion from partnership to corporation. This ruling explains the federal tax consequences when an entity classified as a partnership for federal tax purposes converts into a state law corporation under a state statute that does not require an actual transfer of the unincorporated entity's assets or interests.

Rev. Rul. 2004–59

ISSUE

If an unincorporated state law entity that is classified as a partnership for federal tax purposes (partnership) converts to a state law corporation under a state statute that does not require an actual transfer of the unincorporated entity's assets or interests (state law formless conversion statute), how is the conversion treated for federal tax purposes?

FACTS

On January 1, 2003, *A* is organized in *State* as an unincorporated entity that is classified as a partnership for federal tax purposes. *A* elects to convert under a state law formless conversion statute into a state law corporation, effective January 1, 2004. As a result of the conversion, *A* is classified as a corporation for federal tax purposes.

LAW AND ANALYSIS

Section 7701(a)(2) of the Internal Revenue Code provides that the term partnership includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation.

Section 7701(a)(3) provides that the term corporation includes associations, joint-stock companies, and insurance companies.

Section 301.7701–2(b)(1) defines the term corporation to include a business entity organized under a federal or state statute, or under a statute of a federally recognized Indian tribe, if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic.

Section 301.7701–3(a) provides that a business entity that is not classified as a corporation under § 301.7701–2(b)(1), (3), (4), (5), (6), (7) or (8) (an eligible entity), can elect its classification for federal tax purposes.

Section 301.7701–3(g)(1)(i) provides that, if an eligible entity classified as a partnership elects under § 301.7701–3(c)(1)(i) to be classified as an association, the following is deemed to occur: the partnership contributes all its assets and liabilities to the association in exchange for stock in the association, and immediately thereafter, the partnership liquidates, distributing the stock of the association to its partners.

Rev. Rul. 84–111, 1984–2 C.B. 88, describes the tax consequences when steps are taken as parts of a plan to transfer partnership operations to a corporation organized for valid business reasons. For each of three methods of incorporating a partnership, Rev. Rul. 84–111 describes the differences in the basis and holding periods of the various assets received by the corporation and the basis and holding periods of the stock received by the former partners provided the steps described are actually undertaken and the underlying assumptions and purposes for the conclusions in the revenue ruling are applicable. If the partnership converts into a corporation in accordance with a state law formless conversion statute, however, Rev. Rul. 84–111 does not apply.

For federal tax purposes, a partnership that converts to a corporation under a state law formless conversion statute will be treated in the same manner as one that makes an election to be treated as an association under § 301.7701–3(c)(1)(i). Therefore, when unincorporated entity A converts, under state law, to corporation A, the following steps are deemed to occur: unincorporated entity A contributes all of its assets and liabilities to corporation A in exchange for stock in corporation A, and immediately thereafter, unincorporated entity A liquidates, distributing the stock of corporation A to its partners.

HOLDING

If an unincorporated state law entity that is classified as a partnership for federal tax purposes converts into a state law corporation under a state law formless conversion statute, the following is deemed to occur: the partnership contributes all its assets and liabilities to the corporation in exchange for stock in such corporation, and immediately thereafter, the partnership liquidates distributing the stock of the corporation to its partners.

DRAFTING INFORMATION

The principal author of this revenue ruling is Christopher L. Trump of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Christopher L. Trump at (202) 622–3080 (not a toll-free call).

Section 3121.—Definitions

26 CFR 31.3121(a)–1: Wages.
(Also: 31.3306(b)–1, 31.3401(a)–1.)

Federal Insurance Contributions Act (FICA); options and deferred compensation transfer on divorce. This ruling concludes that nonqualified stock options and nonqualified deferred compensation transferred by an employee to a former spouse incident to a divorce are subject to the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and income tax withholding to the same extent as if retained by the employee. The ruling also provides reporting requirements applicable to the wage payments. Notice 2002–31 modified.

Rev. Rul. 2004–60

ISSUES:

(1) What is the effect upon taxation under the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source on Wages (income tax withholding) of a transfer of interests in a nonstatutory stock option and in nonqualified deferred compensation to a former spouse incident to a divorce?

(2) What is the appropriate reporting of income and/or wages recognized with respect to nonstatutory stock options and nonqualified deferred compensation transferred to a former spouse incident to a divorce?

FACTS

The facts are the same as in Rev. Rul. 2002–22, 2002–1 C.B. 849, and are restated here for convenience.

Prior to their divorce in 2002, *A* and *B* were married individuals residing in State *X* who used the cash receipts and disbursements method of accounting.

A is employed by Corporation *Y*. Prior to the divorce, *Y* issued nonstatutory stock options to *A* as part of *A*'s compensation. The nonstatutory stock options did not have a readily ascertainable fair market value within the meaning of § 1.83–7(b) of the Income Tax Regulations at the time granted to *A*, and thus no amount was included in *A*'s gross income with respect to those options at the time of grant.

Y maintains two unfunded, deferred compensation plans under which *A* earns the right to receive post-employment payments from *Y*. Under one of the deferred compensation plans, participants are entitled to payments based on the balance of individual accounts of the kind described in § 31.3121(v)(2)–1(c)(1)(ii) of the Employment Tax Regulations. By the time of *A*'s divorce from *B*, *A* had an account balance of $100*x* under that plan. Under the second deferred compensation plan maintained by *Y*, participants are entitled to receive single sum or periodic payments following separation from service based on a formula reflecting their years of service and compensation history with *Y*. By the time of *A*'s divorce from *B*, *A* had accrued the right to receive a single sum payment of $50*x* under the plan following *A*'s termination of employment with *Y*. *A*'s contractual rights to the deferred compensation benefits under these plans were not contingent on *A*'s performance of future services for *Y*.

Under the law of State *X*, stock options and unfunded deferred compensation rights earned by a spouse during the period of marriage are marital property subject to equitable division between the spouses in the event of divorce. Pursuant to the property settlement incorporated into their judgment of divorce, *A* transferred to *B* (1) one-third of the nonstatutory stock options issued to *A* by *Y*, (2) the right to receive deferred compensation payments from *Y* under the account balance plan based on $75*x* of *A*'s account balance under the plan at the time of the divorce, and (3) the right to receive a single sum payment of $25*x* from *Y* under the other deferred compensation plan upon *A*'s termination of employment with *Y*.

In 2006, *B* exercises all of the transferred stock options and receives *Y* stock with a fair market value in excess of the exercise price of the options. In 2011, *A* terminates employment with *Y*, and *B* receives a single sum payment of $150*x* from the account balance plan and a single sum payment of $25*x* from the other deferred compensation plan.

LAW AND ANALYSIS

Rev. Rul. 2002–22 concludes that a taxpayer who transfers interests in nonstatutory stock options and nonqualified deferred compensation to the taxpayer's former spouse incident to divorce is not required to include an amount in gross income upon the transfer. The ruling also concludes that the former spouse, rather than the taxpayer, is required to include an amount in gross income when the former spouse exercises the stock options or when the deferred compensation is paid or made available to the former spouse.

FICA Wages

Sections 3101 and 3111 impose FICA taxes on "wages" as that term is defined in § 3121(a). FICA taxes consist of the Old-Age, Survivors and Disability Insurance tax (social security tax) and the Hospital Insurance tax (Medicare tax). These taxes are imposed on both the employer and employee. Sections 3101(a) and 3101(b) impose the employee portions of the social security tax and the Medicare tax, respectively. Sections 3111(a) and (b) impose the employer portions of the social security tax and the Medicare tax, respectively.

Section 3102(a) provides that the employee portion of FICA taxes must be collected by the employer of the taxpayer by deducting the amount of the tax from wages as and when paid. Section 31.3102(a)–1(a) provides that the employer is required to collect the tax, notwithstanding that wages are paid in something other than money. Section 3102(b) provides that every employer required to deduct the FICA employee tax is liable for the payment of that tax, and is indemnified against the claims and demands of any person for the amount of any such payment made by such employer.

The term "wages" is defined in § 3121(a) for FICA purposes as all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash, with certain specific exceptions. Section 3121(b) defines "employment" as any service, of whatever nature, performed by an employee for the person employing him, with certain specific exceptions.

Section 31.3121(a)–1(e) provides that in general the medium in which the remuneration is paid is immaterial. It may be paid in cash or other than in cash. Remuneration paid in any medium other than cash is computed on the basis of the fair market value of such items at the time of payment.

Under § 3121(v)(2), amounts deferred under a nonqualified deferred compensation plan generally are to be taken into account when the services are performed or, if later, when there is no substantial risk of forfeiture. To the extent benefit payments under a nonqualified deferred compensation plan are attributable to amounts deferred under the plan that have been taken into account for FICA tax purposes, the benefit payments are not treated as FICA wages. To the extent benefit payments are attributable to an amount deferred that has not been taken into account for FICA tax purposes, then the benefit payments are treated as FICA wages. *See* § 31.3121(v)(2)–1(d)(1)(ii).

In the Social Security Amendments of 1983, Public Law No. 98–21, 1983–2 C.B. 309, Congress added language to § 3121(a) providing that nothing in the income tax withholding regulations that provides an exclusion from wages for income tax withholding purposes is to be construed to require a similar exclusion from wages for FICA purposes. The legislative history in connection with this provision states that "[s]ince the [social] security system has objectives which are significantly different from the objective underlying the income tax withholding rules, the committee believes that amounts exempt from income tax withholding should not be exempt from FICA tax unless Congress provides an explicit tax exclusion." S. Rep. No. 23, 98th Cong., 1st Sess. at 42 (1983).

The fact that payments are includible in the gross income of an individual other than an employee does not remove the payments from FICA wages. *See* Rev. Rul. 71–116, 1971–1 C.B. 277, holding that payments of wages to an employee in a community property state are FICA wages although one-half of the wages is includible in the gross income of the nonemployee spouse. *See also* Rev. Rul. 86–109, 1986–2 C.B. 196, which holds that payments of remuneration for employment made after the death of an employee and in the calendar year of the death are wages for FICA tax purposes, although the amounts are includible in the gross income of the recipient and not the employee.

Rev. Rul. 2002–22 holds that, upon the exercise of a nonstatutory stock option obtained by a nonemployee spouse pursuant to divorce, the property transferred to the nonemployee spouse by the employer has the same character and is includible in the income of the nonemployee spouse under § 83(a) to the same extent as the property would have been includible in the income of the employee spouse had the option been retained and exercised by the employee spouse. Rev. Rul. 2002–22 further holds that nonqualified deferred compensation, the right to which is obtained by a nonemployee spouse pursuant to divorce, paid or made available to the nonemployee spouse has the same character and is includible in the income of the nonemployee spouse to the same extent as the compensation would have been includible in the income of the employee spouse had the compensation been paid or made available to the employee spouse. Nothing in § 1041, pertaining to transfers of property between spouses or incident to divorce, excludes payments to a person other than an employee from wages for purposes of FICA. In the absence of a specific provision that would exclude these payments from FICA wages, the compensation realized on the exercise of the stock options by the nonemployee spouse and the deferred compensation paid or made available to the nonemployee spouse retain their character as wages of the employee spouse for purposes of FICA. Thus, the payment of such remuneration is subject to FICA to the same extent as if paid to the employee spouse.

At the same time that the Service published Rev. Rul. 2002–22, it also published Notice 2002–31, 2002–1 C.B. 908, which included a proposed revenue ruling addressing the application of FICA, FUTA, and income tax withholding, and reporting of income and wages, with respect to nonstatutory stock options and nonqualified deferred compensation transferred to a former spouse incident to a divorce (as described in the Facts above), and requested comments on the proposal. In general, the proposed ruling included the conclusion that the exercise of the options and the nonqualified deferred compensation remain subject to FICA and FUTA taxes to the same extent as if they had been retained by the employee, and that the income recognized by the nonemployee spouse with respect to the exercise of the options and distributions of nonqualified deferred compensation are wages for purposes of income tax withholding. The proposed ruling also concluded that any employee FICA taxes and income tax withholding applicable to the exercise of the options or distribution of the nonqualified deferred compensation would be deducted from the payments to the nonemployee spouse.

Accordingly, the nonqualified deferred compensation paid or made available to the former spouse remains subject to the rules of § 3121, including § 3121(v)(2) and the regulations thereunder, to determine when and whether FICA tax is applicable. Thus, to the extent the amount deferred has been previously taken into account for FICA purposes, the distribution to the former spouse of the proceeds of the account balance plan would not be treated as wages for FICA tax purposes. However, to the extent the amount deferred has not been previously taken into account for FICA tax purposes, the distribution to the former spouse of the proceeds of the account balance plan would be wages of the employee for FICA tax purposes. Similarly, under § 3121 and the regulations thereunder, a former spouse's exercise of a nonstatutory stock option results in FICA wages of the employee to the extent that the fair market value of the stock received pursuant to the exercise of the option exceeds the option exercise price.

To the extent the distributed payments are FICA wages, the employee FICA tax is deducted from the payment made to the transferee. The amount includible in the gross income of the transferee is not reduced by any FICA withholding from the payments (including transfers of property) to the transferee. *See* Rev. Rul. 86–109 and Rev. Rul. 71–116.

Because *A* was the service performer and the remuneration relates to *A*'s service in employment with *Y*, the wages, although paid to *B*, are FICA wages of *A*. *See* Rev. Rul. 71–116. Thus, because the payments are wages for FICA tax purposes, the payments are reportable by *Y* as social security wages and Medicare wages on a Form W–2, *Wage and Tax Statement*, issued to *A*, and the social security tax withheld and Medicare tax withheld are also reportable on the Form W–2 to *A*. *Y* may take into account other wages previously paid to *A* in that calendar year in determining whether these distributions are excepted from social security wages under § 3121(a)(1), the maximum social security wage base exception. The employee FICA tax for these wages should be deducted from the payment of these wages. Finally, these payments should not be included in Box 1, Wages, tips, other compensation, nor should any amount be reflected in Box 2, Federal income tax withheld, of the Form W–2 issued to *A* with respect to these payments.

FUTA

The FUTA taxation provisions applicable with respect to nonstatutory stock options and nonqualified deferred compensation plans are similar to the FICA provisions, except that only the employer pays the tax imposed under FUTA. *See* §§ 3301, 3306(b), and 3306(r)(2) and the regulations thereunder. Because of the similar statutory provisions, FUTA taxation applies at the same time and in the same manner as FICA. To the extent wage taxation applies, the wages are FUTA wages of the employee *A*, subject to the maximum wage base contained in § 3306(b)(1). As with FICA, wages previously paid to the employee during the calendar year may be taken into account in determining whether these amounts qualify for the FUTA maximum wage base exception.

Income Tax Withholding

Section 3402(a), relating to income tax withholding, generally requires every employer making a payment of wages to deduct and withhold upon those wages a tax determined in accordance with prescribed tables or computational procedures.

Section 3401(a) provides that "wages" for income tax withholding purposes means all remuneration for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash, with certain exceptions not pertinent to this ruling.

Under § 31.3402(a)–1(c), an employer is required to deduct and withhold the tax notwithstanding that the wages are paid in something other than money (for example, wages paid in stock or bonds) and to pay over the tax in money. If the wages are paid in property other than money, the employer should make necessary arrangements to insure that the amount of the tax required to be withheld is available for payment in money.

Section 31 provides that the amount withheld from wages as income tax withholding will be allowed to the "recipient of the income" as a credit against the income taxes imposed by Subtitle A. Section 1.31–1(a) of the Income Tax Regulations provides that the "recipient of the income" for purposes of the § 31 credit is the individual who is subject to income taxes upon the wages from which the tax was withheld. For example, if an employee spouse and nonemployee spouse are domiciled in a community property state and file separate income tax returns, each reporting for income tax purposes one-half of the wages received by the employee spouse, each spouse is entitled to one-half of the credit allowable for the tax withheld at the source with respect to the wages.

Because the compensatory interests transferred under §1041 to the nonemployee spouse pursuant to the divorce remain taxable for employment tax purposes to the same extent as if retained by the employee spouse, the income recognized by the nonemployee spouse with respect to the exercise of the nonstatutory stock options and the distributions from the nonqualified deferred compensation plans are remuneration for employment and wages for purposes of income tax withholding under § 3402. Pursuant to §1.31–1(a), because the income recognized with respect to this compensation is includible in the gross income of the nonemployee spouse, the nonemployee spouse is entitled to the credit for the income tax withheld with respect to these wage payments.

Employers are not required to collect Form W–4, *Employee's Withholding Allowance Certificate*, from the nonemployee spouse, and should not base withholding on a Form W–4 submitted by the nonemployee spouse. Employers may treat the compensation includible in the income of the nonemployee spouse as supplemental wages and apply the flat rate withholding method on supplemental wages in withholding income tax on these wages. The flat rate for withholding on supplemental wages is currently 25 percent. *See* § 101(c)(11) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. L. No. 107–16), which provides that the flat rate for withholding on supplemental wages is the third lowest rate of tax applicable under § 1(c) of the Code, and §§ 1(c), 1(i)(1)(A)(i), and 1(i)(2) of the Code, which provide that the third lowest rate of tax applicable under § 1(c) is 25 percent.

Reporting of payments

Section 6051 requires payors of remuneration to an employee to report those payments on Form W–2, *Wage and Tax Statement*. Because the former spouse is not an employee, the reporting requirements of § 6051 do not apply.

Section 6041(a) and the accompanying regulations generally require that all persons engaged in a trade or business who make a payment to a third party during the course of such business must file an information return with the IRS, reporting all payments totaling $600 or more in a taxable year, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits and income. In this case, pursuant to § 6041(a), *Y* must file an information return reporting both the income *B* realized from *B*'s exercise of the nonstatutory stock options and the payments made to *B* from the deferred compensation plans.

Under § 31.6051–1(a)(1), the wages of an employee that are subject to social security and Medicare taxes are included in the appropriate boxes on the Form W–2 issued to the employee. *See also* Rev. Rul. 71–116.

Because there is no provision for the issuance of Form W–2 in the name of a nonemployee spouse, the income realized upon the exercise of the nonstatutory stock options would be reportable to the nonemployee spouse by *Y* on Form 1099–MISC, *Miscellaneous Income*, issued to the nonemployee spouse, in Box 3, Other income, with the income tax withheld reported in Box 4, Federal income tax withheld. The payments to the nonemployee spouse *B* from the nonqualified deferred compensation plans and the withholding thereon would also be reportable by *Y* on a Form 1099–MISC in Box 3, with the income tax withheld reported in Box 4.

Social security wages, social security tax withheld, Medicare wages, and Medicare taxes withheld, if applicable, are reported on the employee spouse's Form W–2 as described above.

Employers would report the income tax withholding on wages paid to the nonemployee spouse on Form 945, *Annual Return of Withheld Federal Income Tax*. The social security and Medicare tax paid with respect to these wages of the employee spouse would be reported on Form 941, *Employer's Quarterly Federal Tax Return*. FUTA tax with respect to wages of the employee spouse would be reported on Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*.

HOLDINGS

(1) The transfer of interests in nonstatutory stock options and in nonqualified deferred compensation from the employee spouse to the nonemployee spouse incident to a divorce does not result in a payment of wages for FICA and FUTA tax purposes.

The nonstatutory stock options are subject to FICA and FUTA taxes at the time of exercise by the nonemployee spouse to the same extent as if the options had been retained by the employee spouse and exercised by the employee spouse. The nonqualified deferred compensation also remains subject to FICA and FUTA taxes to the same extent as if the rights to the compensation had been retained by the employee spouse. To the extent FICA and FUTA taxation apply, the wages are the wages of the employee spouse. The employee portion of the FICA taxes is deducted from the wages as and when the wages are taken into account for FICA tax purposes. The employee portion of the FICA taxes is deducted from the payment to the nonemployee spouse.

The income recognized by the nonemployee spouse with respect to the exercise of the nonstatutory stock options is subject to withholding under § 3402. The amounts distributed to the nonemployee spouse from the nonqualified deferred compensation plans are also subject to withholding under § 3402. The amounts to be withheld for income tax withholding are deducted from the payments to the nonemployee spouse. The supplemental wage flat rate may be used to determine the amount of income tax withholding. Pursuant to § 31, the nonemployee spouse is entitled to the credit allowable for the income tax withheld at the source on these wages.

(2) The social security wages, Medicare wages, social security taxes withheld, and Medicare taxes withheld, if applicable, are reportable on a Form W–2 with the name, address, and social security number of the employee spouse. However, no amount is includible in Box 1 and Box 2 of the employee's Form W–2 with respect to these payments. The income with respect to the exercise of the nonstatutory stock options by the nonemployee spouse and the distributions from the nonqualified deferred compensation plans to the nonemployee spouse are reportable in Box 3 as other income on a Form 1099–MISC with the name, address, and social security number of the nonemployee spouse. Income tax withholding with respect to these payments of wages is included in Box 4, Federal income tax withheld.

Income tax withholding on payments to the nonemployee spouse is included on a Form 945 filed by *Y*. The social security tax and Medicare tax are reported on *Y*'s Form 941, and the FUTA tax is reported on *Y*'s Form 940.

EFFECT ON OTHER PUBLISHED ITEMS

Notice 2002–31, 2002–1 C.B. 908, included a proposed revenue ruling addressing the application of FICA, FUTA, and income tax withholding, and reporting of income and/or wages with respect to nonstatutory stock options and nonqualified deferred compensation transferred to a former spouse incident to a divorce, and requested comments on the proposal. After consideration of the comments that were received, the proposed ruling is adopted as revised by this revenue ruling.

PROSPECTIVE APPLICATION

This revenue ruling is effective January 1, 2005. For periods before the effective date, employers may rely on a reasonable, good faith interpretation including the interpretations in the proposed revenue ruling in Notice 2002–31 and this revenue ruling. However, with respect to compensation transferred to a spouse incident to divorce, failure to treat nonstatutory stock option compensation, or amounts deferred under a nonqualified deferred compensation plan, as subject to FICA will not be considered a reasonable, good faith interpretation.

DRAFTING INFORMATION

The principal author of this revenue ruling is A. G. Kelley of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Mr. Kelley at (202) 622–6040 (not a toll-free call).

Section 3306.—Definitions

What is the effect upon taxation under the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source on Wages (income tax withholding) of a transfer of interests in a nonstatutory stock option and in nonqualified deferred compensation to a former spouse incident to a divorce? See Rev. Rul. 2004-60, page 1051.

Section 3401.—Definitions

What is the effect upon taxation under the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source on Wages (income tax withholding) of a transfer of interests in a nonstatutory stock option and in nonqualified deferred compensation to a former spouse incident to a divorce? See Rev. Rul. 2004-60, page 1051.

Section 6621.—Determination of Rate of Interest

26 CFR 301.6621–1: Interest rate.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning July 1, 2004, will be 4 percent for overpayments (3 percent in the case of a corporation), 4 percent for underpayments, and 6 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 will be 1.5 percent.

Rev. Rul. 2004–56

Section 6621 of the Internal Revenue Code establishes the rates for interest on tax overpayments and tax underpayments. Under section 6621(a)(1), the overpayment rate beginning July 1, 2004, is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point for interest computations made after December 31, 1994. Under section 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under section 6601 on any large corporate underpayment, the underpayment rate under section 6621(a)(2) is determined by substituting "5 percentage points" for "3 percentage points." See section 6621(c) and section 301.6621–3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and section 301.6621–3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) provides that the federal short-term rate determined under section 6621(b)(1) for any month applies during the first calendar quarter beginning after such month.

Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during such month by the Secretary in accordance with § 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88–59, 1988–1 C.B. 546, announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under section 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with section 6621 which, pursuant to section 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of April 2004 is 1 percent. Accordingly, an overpayment rate of 4 percent (3 percent in the case of a corporation) and an underpayment rate of 4 percent are established for the calendar quarter beginning July 1, 2004. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning July 1, 2004, is 1.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning July 1, 2004, is 6 percent. These rates apply to amounts bearing interest during that calendar quarter.

Interest factors for daily compound interest for annual rates of 1.5 percent, 3 percent, 4 percent, and 6 percent are published in Tables 56, 59, 61, and 65 of Rev. Proc. 95–17, 1995–1 C.B. 556, 610, 613, 615, and 619.

Annual interest rates to be compounded daily pursuant to section 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Crystal Foster of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue ruling, contact Ms. Foster at (202) 622–7326 (not a toll-free call).

TABLE OF INTEREST RATES
PERIODS BEFORE JUL. 1, 1975 – PERIODS ENDING DEC. 31, 1986
OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	In 1995–1 C.B. DAILY RATE TABLE
Before Jul. 1, 1975	6%	Table 2, pg. 557
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 559
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 558
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 557
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 560
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 560
Jan. 1, 1983—Jun. 30, 1983	16%	Table 37, pg. 591
Jul. 1, 1983—Dec. 31, 1983	11%	Table 27, pg. 581
Jan. 1, 1984—Jun. 30, 1984	11%	Table 75, pg. 629
Jul. 1, 1984—Dec. 31, 1984	11%	Table 75, pg. 629
Jan. 1, 1985—Jun. 30, 1985	13%	Table 31, pg. 585
Jul. 1, 1985—Dec. 31, 1985	11%	Table 27, pg. 581
Jan. 1, 1986—Jun. 30, 1986	10%	Table 25, pg. 579
Jul. 1, 1986—Dec. 31, 1986	9%	Table 23, pg. 577

TABLE OF INTEREST RATES
FROM JAN. 1, 1987 – Dec. 31, 1998

	OVERPAYMENTS			UNDERPAYMENTS		
	1995–1 C.B.			1995–1 C.B.		
	RATE	TABLE	PG	RATE	TABLE	PG
Jan. 1, 1987—Mar. 31, 1987	8%	21	575	9%	23	577
Apr. 1, 1987—Jun. 30, 1987	8%	21	575	9%	23	577
Jul. 1, 1987—Sep. 30, 1987	8%	21	575	9%	23	577
Oct. 1, 1987—Dec. 31, 1987	9%	23	577	10%	25	579
Jan. 1, 1988—Mar. 31, 1988	10%	73	627	11%	75	629
Apr. 1, 1988—Jun. 30, 1988	9%	71	625	10%	73	627
Jul. 1, 1988—Sep. 30, 1988	9%	71	625	10%	73	627
Oct. 1, 1988—Dec. 31, 1988	10%	73	627	11%	75	629
Jan. 1, 1989—Mar. 31, 1989	10%	25	579	11%	27	581
Apr. 1, 1989—Jun. 30, 1989	11%	27	581	12%	29	583
Jul. 1, 1989—Sep. 30, 1989	11%	27	581	12%	29	583
Oct. 1, 1989—Dec. 31, 1989	10%	25	579	11%	27	581
Jan. 1, 1990—Mar. 31, 1990	10%	25	579	11%	27	581
Apr. 1, 1990—Jun. 30, 1990	10%	25	579	11%	27	581
Jul. 1, 1990—Sep. 30, 1990	10%	25	579	11%	27	581
Oct. 1, 1990—Dec. 31, 1990	10%	25	579	11%	27	581
Jan. 1, 1991—Mar. 31, 1991	10%	25	579	11%	27	581
Apr. 1, 1991—Jun. 30, 1991	9%	23	577	10%	25	579
Jul. 1, 1991—Sep. 30, 1991	9%	23	577	10%	25	579
Oct. 1, 1991—Dec. 31, 1991	9%	23	577	10%	25	579
Jan. 1, 1992—Mar. 31, 1992	8%	69	623	9%	71	625
Apr. 1, 1992—Jun. 30, 1992	7%	67	621	8%	69	623
Jul. 1, 1992—Sep. 30, 1992	7%	67	621	8%	69	623
Oct. 1, 1992—Dec. 31, 1992	6%	65	619	7%	67	621
Jan. 1, 1993—Mar. 31, 1993	6%	17	571	7%	19	573
Apr. 1, 1993—Jun. 30, 1993	6%	17	571	7%	19	573
Jul. 1, 1993—Sep. 30, 1993	6%	17	571	7%	19	573
Oct. 1, 1993—Dec. 31, 1993	6%	17	571	7%	19	573
Jan. 1, 1994—Mar. 31, 1994	6%	17	571	7%	19	573

TABLE OF INTEREST RATES
FROM JAN. 1, 1987 – Dec. 31, 1998

	OVERPAYMENTS			UNDERPAYMENTS		
	1995–1 C.B.			1995–1 C.B.		
	RATE	TABLE	PG	RATE	TABLE	PG
Apr. 1, 1994—Jun. 30, 1994	6%	17	571	7%	19	573
Jul. 1, 1994—Sep. 30, 1994	7%	19	573	8%	21	575
Oct. 1, 1994—Dec. 31, 1994	8%	21	575	9%	23	577
Jan. 1, 1995—Mar. 31, 1995	8%	21	575	9%	23	577
Apr. 1, 1995—Jun. 30, 1995	9%	23	577	10%	25	579
Jul. 1, 1995—Sep. 30, 1995	8%	21	575	9%	23	577
Oct. 1, 1995—Dec. 31, 1995	8%	21	575	9%	23	577
Jan. 1, 1996—Mar. 31, 1996	8%	69	623	9%	71	625
Apr. 1, 1996—Jun. 30, 1996	7%	67	621	8%	69	623
Jul. 1, 1996—Sep. 30, 1996	8%	69	623	9%	71	625
Oct. 1, 1996—Dec. 31, 1996	8%	69	623	9%	71	625
Jan. 1, 1997—Mar. 31, 1997	8%	21	575	9%	23	577
Apr. 1, 1997—Jun. 30, 1997	8%	21	575	9%	23	577
Jul. 1, 1997—Sep. 30, 1997	8%	21	575	9%	23	577
Oct. 1, 1997—Dec. 31, 1997	8%	21	575	9%	23	577
Jan. 1, 1998—Mar. 31, 1998	8%	21	575	9%	23	577
Apr. 1, 1998—Jun. 30, 1998	7%	19	573	8%	21	575
Jul. 1, 1998—Sep. 30, 1998	7%	19	573	8%	21	575
Oct. 1, 1998—Dec. 31, 1998	7%	19	573	8%	21	575

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 – PRESENT
NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

		1995–1 C.B.	
	RATE	TABLE	PAGE
Jan. 1, 1999—Mar. 31, 1999	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	6%	17	571
Oct. 1, 2002—Dec. 31, 2002	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	4%	61	615
Apr. 1, 2004—Jun. 31, 2004	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	4%	61	615

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 – PRESENT
CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
	1995–1 C.B.			1995–1 C.B.		
	RATE	TABLE	PG	RATE	TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	6%	17	571	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	7%	19	573	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	7%	19	573	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	7%	19	573	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	7%	67	621	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	8%	69	623	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	8%	69	623	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	8%	69	623	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	8%	21	575	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	7%	19	573	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	6%	17	571	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	6%	17	571	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	5%	15	569	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	5%	15	569	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	5%	15	569	6%	17	571
Oct. 1, 2002—Dec. 31, 2002	5%	15	569	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	4%	13	567	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	4%	13	567	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	4%	13	567	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	3%	11	565	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	3%	59	613	4%	61	615
Apr. 1, 2004—Jun. 31, 2004	4%	61	615	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	3%	59	613	4%	61	615

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS
FROM JANUARY 1, 1991 – PRESENT

		1995–1 C.B.	
	RATE	TABLE	PG
Jan. 1, 1991—Mar. 31, 1991	13%	31	585
Apr. 1, 1991—Jun. 30, 1991	12%	29	583
Jul. 1, 1991—Sep. 30, 1991	12%	29	583
Oct. 1, 1991—Dec. 31, 1991	12%	29	583
Jan. 1, 1992—Mar. 31, 1992	11%	75	629
Apr. 1, 1992—Jun. 30, 1992	10%	73	627
Jul. 1, 1992—Sep. 30, 1992	10%	73	627
Oct. 1, 1992—Dec. 31, 1992	9%	71	625
Jan. 1, 1993—Mar. 31, 1993	9%	23	577
Apr. 1, 1993—Jun. 30, 1993	9%	23	577
Jul. 1, 1993—Sep. 30, 1993	9%	23	577
Oct. 1, 1993—Dec. 31, 1993	9%	23	577
Jan. 1, 1994—Mar. 31, 1994	9%	23	577
Apr. 1, 1994—Jun. 30, 1994	9%	23	577
Jul. 1, 1994—Sep. 30, 1994	10%	25	579
Oct. 1, 1994—Dec. 31, 1994	11%	27	581
Jan. 1, 1995—Mar. 31, 1995	11%	27	581

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS
FROM JANUARY 1, 1991 – PRESENT

		1995–1 C.B.	
	RATE	TABLE	PG
Apr. 1, 1995—Jun. 30, 1995	12%	29	583
Jul. 1, 1995—Sep. 30, 1995	11%	27	581
Oct. 1, 1995—Dec. 31, 1995	11%	27	581
Jan. 1, 1996—Mar. 31, 1996	11%	75	629
Apr. 1, 1996—Jun. 30, 1996	10%	73	627
Jul. 1, 1996—Sep. 30, 1996	11%	75	629
Oct. 1, 1996—Dec. 31, 1996	11%	75	629
Jan. 1, 1997—Mar. 31, 1997	11%	27	581
Apr. 1, 1997—Jun. 30, 1997	11%	27	581
Jul. 1, 1997—Sep. 30, 1997	11%	27	581
Oct. 1, 1997—Dec. 31, 1997	11%	27	581
Jan. 1, 1998—Mar. 31, 1998	11%	27	581
Apr. 1, 1998—Jun. 30, 1998	10%	25	579
Jul. 1, 1998—Sep. 30, 1998	10%	25	579
Oct. 1, 1998—Dec. 31, 1998	10%	25	579
Jan. 1, 1999—Mar. 31, 1999	9%	23	577
Apr. 1, 1999—Jun. 30, 1999	10%	25	579
Jul. 1, 1999—Sep. 30, 1999	10%	25	579
Oct. 1, 1999—Dec. 31, 1999	10%	25	579
Jan. 1, 2000—Mar. 31, 2000	10%	73	627
Apr. 1, 2000—Jun. 30, 2000	11%	75	629
Jul. 1, 2000—Sep. 30, 2000	11%	75	629
Oct. 1, 2000—Dec. 31, 2000	11%	75	629
Jan. 1, 2001—Mar. 31, 2001	11%	27	581
Apr. 1, 2001—Jun. 30, 2001	10%	25	579
Jul. 1, 2001—Sep. 30, 2001	9%	23	577
Oct. 1, 2001—Dec. 31, 2001	9%	23	577
Jan. 1, 2002—Mar. 31, 2002	8%	21	575
Apr. 1, 2002—Jun. 30, 2002	8%	21	575
Jul. 1, 2002—Sep. 30, 2002	8%	21	575
Oct. 1, 2002—Dec. 30, 2002	8%	21	575
Jan. 1, 2003—Mar. 31, 2003	7%	19	573
Apr. 1, 2003—Jun. 30, 2003	7%	19	573
Jul. 1, 2003—Sep. 30, 2003	7%	19	573
Oct. 1, 2003—Dec. 31, 2003	6%	17	571
Jan. 1, 2004—Mar. 31, 2004	6%	65	619
Apr. 1, 2004—Mar. 31, 2004	7%	67	621
Jul. 1, 2004—Sep. 30, 2004	6%	65	619

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000
FROM JANUARY 1, 1995 – PRESENT

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1995—Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995—Jun. 30, 1995	7.5%	20	574
Jul. 1, 1995—Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995—Dec. 31, 1995	6.5%	18	572
Jan. 1, 1996—Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996—Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996—Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996—Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997—Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997—Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997—Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997—Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998—Mar. 31, 1998	6.5%	18	572
Apr. 1, 1998—Jun. 30, 1998	5.5%	16	570
Jul. 1, 1998—Sep. 30, 1998	5.5%	16	570
Oct. 1, 1998—Dec. 31, 1998	5.5%	16	570
Jan. 1, 1999—Mar. 31, 1999	4.5%	14	568
Apr. 1, 1999—Jun. 30, 1999	5.5%	16	570
Jul. 1, 1999—Sep. 30, 1999	5.5%	16	570
Oct. 1, 1999—Dec. 31, 1999	5.5%	16	570
Jan. 1, 2000—Mar. 31, 2000	5.5%	64	618
Apr. 1, 2000—Jun. 30, 2000	6.5%	66	620
Jul. 1, 2000—Sep. 30, 2000	6.5%	66	620
Oct. 1, 2000—Dec. 31, 2000	6.5%	66	620
Jan. 1, 2001—Mar. 31, 2001	6.5%	18	572
Apr. 1, 2001—Jun. 30, 2001	5.5%	16	570
Jul. 1, 2001—Sep. 30, 2001	4.5%	14	568
Oct. 1, 2001—Dec. 31, 2001	4.5%	14	568
Jan. 1, 2002—Mar. 31, 2002	3.5%	12	566
Apr. 1, 2002—Jun. 30, 2002	3.5%	12	566
Jul. 1, 2002—Sep. 30, 2002	3.5%	12	566
Oct. 1, 2002—Dec. 31, 2002	3.5%	12	566
Jan. 1, 2003—Mar. 31, 2003	2.5%	10	564
Apr. 1, 2003—Jun. 30, 2003	2.5%	10	564
Jul. 1, 2003—Sep. 30, 2003	2.5%	10	564
Oct. 1, 2003—Dec. 31, 2003	1.5%	8	562
Jan. 1, 2004—Mar. 31, 2004	1.5%	56	610
Apr. 1, 2004—Mar. 31, 2004	2.5%	58	612
Jul. 1, 2004—Sep. 30, 2004	1.5%	56	610

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions and Other Related Items

Supplemental Tables of Income Tax Rates Under New Income Tax Convention With Japan

Announcement 2004–54

The United States recently exchanged instruments of ratification for a new income tax treaty with Japan.

Effective dates. The provisions for withholding tax at source are effective for amounts paid or credited after July 1, 2004. For all other taxes, the treaty is effective for tax periods beginning on or after January 1, 2005.

An individual who claimed treaty benefits under Article 19 (teachers and researchers) or Article 20 (students and trainees) of the former treaty can continue to apply those provisions. A person entitled to benefits under the previous treaty with Japan can elect to have that treaty apply in its entirety for the 12 month period following the date the new treaty would otherwise apply.

Tables 1 and 2. The following tables can be used, depending on the effective dates, to replace the entries for Japan in Tables 1 and 2 in Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities (For Withholding in 2004)*. More information on the new treaty can be found in Publication 901, *U.S. Tax Treaties* (Rev. May 2004). The footnotes in those publications that relate to the column headings in these tables generally apply to these replacement entries.

You can find the complete text of the U.S.-Japan treaty on the Internet at *www.irs.gov*.

Table 1. **Withholding Tax Rates on Income Other Than Personal Services** (The effective dates are shown earlier.)

Income code number		**1**	**2**	**3**	**6**	**7**	**9**	**10**	**11**	**12**	**13**	**14**	**21**
Country/Code													
Japan	JA	10 a,b,c,d	10 a,b,c,d,e	10 a,b,c,d	10 a,c,d,f	5 a,c,d,f,g	0 a,h	0 a,c	0 a,c	0 a,c	30	0 i	0

Income Codes

1	Interest paid by U.S. obligors — General	10	Industrial royalties
2	Interest on real property mortgages	11	Copyright royalties — Motion pictures and Television
3	Interest paid to controlling foreign corporations	12	Copyright royalties — Other
6	Dividends paid by U.S. corporations — General	13	Real property income and Natural resources royalties
7	Dividends qualifying for direct dividend rate	14	Pensions and annuities
9	Capital gains	21	Social security payment

Footnotes

a The exemption or reduction in rate does not apply if the recipient has a permanent establishment in the United States and the property giving rise to the income is effectively connected with this permanent establishment.

b Interest is exempt if a) paid to certain financial institutions, or b) paid on indebtedness from the sale on credit of equipment or merchandise.

c Exemption or reduced rate does not apply to certain amounts paid under, or as part of, a conduit arrangement.

d Amounts paid to a pension fund that are not derived from the carrying on of a business by the fund are exempt.

e Exemption or reduced rate does not apply to an excess inclusion for a residual interest in a real estate mortgage investment conduit (REMIC).

f The rate in column 6 applies to dividends paid by a regulated investment company (RIC) or real estate investment trust (REIT). However, that rate applies to dividends paid by a REIT only if the beneficial owner of the dividends is (a) an individual or a pension fund holding not more than a 10% interest in the REIT, (b) a person holding not more than 5% of any class of the REIT's stock and the dividends are paid on stock that is publicly traded, or (c) a person holding not more than a 10% interest in the REIT and the REIT is diversified. Dividends paid to a pension fund from a RIC, or a REIT that meets the above conditions, are exempt.

g The reduced rate applies if the company receiving the dividends owns at least 10% of the voting stock of the company paying the dividends. Dividends paid by a more than 50% owned corporate subsidiary are exempt if certain conditions are met.

h Exemption does not apply to gains on the sale of real property.

i Exemption does not apply to U.S. Government (federal, state, or local) pensions and annuities; a 30% rate applies to these pensions and annuities. U.S. Government pensions paid to an individual who is both a resident and national of Japan are exempt from U.S. tax.

Table 2. **Compensation for Personal Services Performed in United States Exempt from Withholding and U.S. Income Tax Under Income Tax Treaties** (The effective dates are shown earlier.)

Country	Code	Category of personal services / Purpose	Maximum presence in U.S.	Required Employer or Payer	Maximum Amount of Compensation	Article No.
Japan	16	Independent personal services [2,6]				
	20	Public entertainment	No limit	Any contractor	$10,000 p.a. [5]	16
	17	Dependent personal services [1,2]	183 days	Any foreign resident	No limit	14
	20	Public entertainment	No limit	Any U.S. or foreign resident	$10,000 p.a. [5]	16
	18	Teaching or research [3]	2 years	U.S. educational institution	No limit	20
	19	Studying and training:				
		Remittances or allowances	1 year [4]	Any foreign resident	No limit	19

Footnotes

1 The exemption does not apply if the employee's compensation is borne by a permanent establishment that the employer has in the United States.
2 Does not apply to amounts received as a director of a U.S. corporation.
3 Does not apply to income for research work primarily for private benefit.
4 The time limit applies only to a business apprentice.
5 Does not apply if the gross receipts (including reimbursements) exceed this amount.
6 Treated as business profits under Article 7 of the treaty.

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, §§ 446, 481; 1.446–1.)

Rev. Proc. 2004–36

SECTION 1. PURPOSE

This revenue procedure provides a safe harbor method of accounting under which a taxpayer within the scope of this revenue procedure may amortize creative property costs (as defined in section 2.01 below) ratably over a 15-year period. This revenue procedure also provides procedures for taxpayers to obtain the automatic consent of the Commissioner of Internal Revenue to change to the safe harbor method of accounting provided in this revenue procedure.

SECTION 2. DEFINITIONS

The following definitions apply solely for the purpose of this revenue procedure:

.01 *Creative property costs*. Costs paid or incurred for federal tax purposes to acquire and develop screenplays, scripts, story outlines, motion picture production rights to books and plays, and other similar properties (creative properties) for purposes of potential future film development, production, and exploitation.

.02 *Film*. Feature films, television specials, television series, and similar products (including animated films and television programming) that are sold, licensed or exhibited, whether produced on film, videotape, digital, or other video recording format.

.03 *Set for production*. Management, with relevant authority, implicitly or explicitly authorizes and commits to funding the production of a film, active pre-production has begun, and the start of principal photography is expected to begin within 6 months of being set for production.

.04 *SOP 00–2*. The American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 00–2, "Accounting for Producers or Distributors of Films."

.05 *Initial write-off*. The earliest date on which the taxpayer properly writes off under SOP 00–2 any creative property costs paid or incurred with respect to a particular creative property.

SECTION 3. BACKGROUND

.01 Film studios (studios) routinely incur costs to acquire, produce, and develop creative properties. Studios may acquire these creative properties with exclusive rights of ownership, or they may have limited exploitation rights. Sometimes the rights acquired survive indefinitely while in other situations, the studios may acquire rights with a limited term. Studios ultimately set for production only a small percentage of the creative properties acquired. Most of the creative properties set for production are set within 3 years of acquisition of the property. However, studios set some properties for production that have been held for longer than 3 years. Studios do not usually discard, release to the public domain, or otherwise dispose of the creative properties not set for production or sold. Generally, studios retain these properties indefinitely.

.02 On June 12, 2000, the AICPA issued SOP 00–2, and rescinded Statement of Financial Accounting Standards No. 53. SOP 00–2 is effective for fiscal years beginning after December 15, 2000. SOP 00–2 established new generally accepted accounting principles for financial reporting purposes for the way studios account for creative property costs. SOP 00–2 states that an entity should periodically review creative properties in order to determine whether they will be used in the production of a film. SOP 00–2 states that "[w]hen an entity determines that a property will not be used (disposed of), it should recognize any loss by a charge to the income statement." SOP 00–2 further states that it is presumed that an entity will dispose of a property (whether by sale or abandonment) if it has not been set for production within 3 years from the time of the first capitalized transaction. Amounts written off should not be subsequently reestablished as assets.

.03 Section 165(a) of the Internal Revenue Code allows a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise.

.04 Rev. Rul. 2004–58, 2004–24 I.R.B. 1043, concludes that a taxpayer may not deduct the costs of acquiring and developing creative property as a loss under § 165(a) if the taxpayer does not establish an intention to abandon the property and an affirmative act of abandonment, or identifiable event(s) evidencing a closed or completed transaction establishing worthlessness.

.05 Thus, taxpayers generally are required under the Code and regulations to capitalize creative property costs and, unless a film is produced from the creative property, are not permitted to recover those costs through deductions for depreciation or amortization. *See* Rev. Rul. 79–285, 1979–2 C.B. 91. However, to minimize disputes regarding the accounting for creative property costs, the Internal Revenue Service, as a matter of administrative convenience, will allow a taxpayer that complies with the requirements of this revenue procedure to use the safe harbor amortization method described in section 5 of this revenue procedure for these costs.

SECTION 4. SCOPE

This revenue procedure applies to taxpayers engaged in the trade or business of film production that choose to account for creative property costs under the safe harbor method provided in section 5 of this revenue procedure.

SECTION 5. SAFE HARBOR METHOD

.01 *In general*. The Service will not challenge the use of this safe harbor method of accounting by a taxpayer within the scope of this revenue procedure provided the taxpayer follows all of the requirements of this section 5 and, if the taxpayer is changing from another method to the safe harbor method, the provisions of section 6 of this revenue procedure regarding changes in method of accounting. Under the safe harbor method, the taxpayer must amortize creative property costs properly written off by the taxpayer under SOP 00–2 ratably over an amortization period of 15 years beginning on the first day of the second half of the taxable year in which the taxpayer properly writes off the costs under SOP 00–2. For example, for a calendar-year taxpayer with a full 12-month taxable year, the first day of the second half of the taxable year is July 1st. All creative property costs that the taxpayer begins to amortize under this safe harbor method in the same taxable year are treated as a single asset. Creative property costs that the taxpayer amortizes under this safe harbor method must not be subsequently reestablished as assets, even if a particular creative property is set for production subsequent to the initial write-off. See section 5.02 of this revenue procedure for rules regarding creative property costs paid or incurred subsequent to the initial write-off, whether or not the creative property has been set for production subsequent to the initial write-off. Except as provided in section 5.03 and 5.04 of this revenue procedure, no disposition or other event accelerates recovery of the creative property costs that the taxpayer has begun to amortize under this safe harbor method.

.02 *Costs paid or incurred subsequent to the initial write-off*.

(1) *Property not set for production*. Creative property costs that are (a) associated with a particular creative property that has not been set for production and (b) paid or incurred by the taxpayer subsequent to the initial write-off must be amortized by the taxpayer (in accordance with section 5.01 of this revenue procedure) ratably over an amortization period of 15 years beginning on the first day of the second half of the taxable year in which the taxpayer pays or incurs those costs.

(2) *Property set for production*. Creative property costs that are (a) associated with a particular creative property that has been set for production subsequent to the initial write-off and (b) paid or incurred by the taxpayer after the property is set for production must be capitalized by the taxpayer from the time the property is set for production and depreciated using an allowable depreciation method for produced films (for example, income forecast method) at the time the property is placed in service by the taxpayer.

.03 *Costs associated with property upon disposition*. If, during the 15-year amortization period, creative property rights are disposed of, the taxpayer must nevertheless continue to amortize the creative property costs over the remainder of the 15-year period. A disposition includes the sale, exchange, abandonment, or destruction of creative property or the rights relating thereto. A disposition also occurs upon the expiration of a taxpayer's rights to a particular creative property. Immediately before a disposition, the creative property or creative property rights are treated as having an adjusted basis of zero for purposes of § 1011. Therefore, no loss shall be realized upon a disposition. Any amount realized on a disposition shall be recognized as ordinary income (notwithstanding any other provision of the Code). However, these rules do not apply if a taxpayer disposes of all of its creative properties, for example, as a result of a sale (not including elective recognition of gain or loss transactions under § 338(h)(10)) of its entire trade or business. Thus, in the case of a disposition of an entire trade or business, any gain from the disposition of creative property rights, the costs for which were accounted for using this safe harbor method, will be treated as ordinary income to the extent of the amortization allowed under this safe harbor method.

.04 *Special rule for certain transfers*. In the case of any creative property transferred in a transaction described in §§ 332, 351, 361, 721, 731, 1031, or 1033, and in any transaction between members of the same affiliated group during any taxable year for which a consolidated return is made by the group, the transferee shall be treated as the transferor for purposes of applying the safe harbor method as described in section 5 of this revenue procedure with respect to so much of the adjusted basis in the hands of the transferee as does not exceed the adjusted basis in the hands of the transferor. However, this section 5.04 does not apply in the case of a termination of a partnership under section 708(b)(1)(B).

SECTION 6. CHANGE IN METHOD OF ACCOUNTING AND AUDIT PROTECTION

.01 *Change in method of accounting*. A change in a taxpayer's treatment of creative property costs is a change in method of accounting to which §§ 446(e) and 481 apply. If a taxpayer within the scope of this revenue procedure wants to change to the safe harbor method provided in this revenue procedure for creative property costs properly written off under SOP 00–2, the taxpayer must follow the automatic change in method of accounting provisions in Rev. Proc. 2002–9, 2002–1 C.B. 327 (as modified by Rev. Proc. 2002–19, 2002–1 C.B. 696 and Rev. Proc. 2002–54, 2002–2 C.B. 432, and as modified and clarified by Announcement 2002–17, 2002–1 C.B. 561) or any successor, with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply to a taxpayer that wants to change to the safe harbor method described in section 5 of this revenue procedure for either its first or second taxable year ending on or after December 31, 2003;

(2) A taxpayer that wants to change to the safe harbor method described in section 5 of this revenue procedure for its first taxable year ending on or after December 31, 2003, and that on or before July 12, 2004, files its original federal income tax return for that year, and that did not change to the safe harbor method described in section 5 of this revenue procedure on that return is not required to comply with the filing requirement in section 6.02(3)(a) of Rev. Proc. 2002–9, provided the taxpayer complies with the following filing requirements. The taxpayer must instead complete and file the Form 3115, *Application for Change in Accounting Method*, in duplicate. The original Form 3115 must be attached to an amended federal income tax return for the taxpayer's first taxable year ending on or after December 31, 2003. This amended return must be filed no later than November 29, 2004. The copy of the Form 3115 must be filed with the national office (see section 6.02(6) of Rev. Proc. 2002–9 for the address) no later than when the taxpayer's amended return is filed; and

(3) For purposes of Line 1a of Form 3115, the designated number for the automatic accounting method change authorized by this revenue procedure is "85".

.02 *Audit protection*. If a taxpayer within the scope of this revenue procedure currently uses a method consistent with the safe harbor method described in section 5 of this revenue procedure, the method of accounting for the taxpayer's creative property costs will not be raised as an issue by the Service in a taxable year that ends before December 31, 2003. Also, if a taxpayer currently uses a method consistent with the safe harbor method described in section 5 of this revenue procedure, and its use of that method is an issue under consideration (within the meaning of section 3.09 of Rev. Proc. 2002–9) in examination, before an appeals office, or before the U.S. Tax Court for any taxable year that ends before December 31, 2003, that issue will not be further pursued by the Service.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–9 is modified and amplified to include this change in method of accounting in section 2 of the APPENDIX.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2003.

DRAFTING INFORMATION

The principal author of this revenue procedure is Lauren Ross Taylor of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Ms. Taylor at (202) 622–3040 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Uniform Capitalization of Interest Expense in Safe Harbor Sale and Leaseback Transactions

REG–148399–02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In this issue of the Bulletin, the IRS is issuing final and temporary regulations (T.D. 9129) relating to the capitalization of interest expense in sale and leaseback transactions under the Economic Recovery Tax Act of 1981 (ERTA) safe harbor leasing provisions. The regulations affect taxpayers that provide purchase money obligations in connection with these transactions. The text of those regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments must be received by August 18, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:RU (REG–148399–02), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:RU (REG–148399–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the IRS Internet site at *www.irs.gov/regs* or the Federal eRulemaking Portal at *http://www.regulations.gov* (indicate IRS and REG–148399–02 or RIN 1545-BB62).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Grant Anderson, (202) 622–4970; concerning submission of comments and/or requests for a public hearing, LaNita Van Dyke, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Final and temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) relating to section 263A(f) of the Internal Revenue Code (Code). The temporary regulations generally provide that a purchase money obligation given by the lessor to the lessee (or a party related to the lessee) in a safe harbor sale and leaseback transaction under former section 168(f)(8) is not "eligible debt" as defined in §1.263A–9(a)(4). The text of those regulations also serves as the text of these proposed regulations. The preamble to the final and temporary regulations explains the amendments.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Grant Anderson of the Office of Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.263A–9 is revised by adding a new paragraph (a)(4)(ix) to read as follows:

[The text of proposed §1.263A–9 (a)(4)(ix) is the same as the text of §1.263A–9T(a)(4)(ix) published elsewhere in this issue of the Bulletin.]

Par. 3. Section 1.263A–15 is amended by adding a new paragraph (a)(3) to read as follows:

§1.263A–15 Effective dates, transitional rules, and anti-abuse rules.

(a) * * *

(3) [The text of proposed paragraph (a)(3) of §1.263A–15 is the same as the text of §1.263A–15T published elsewhere in this issue of the Bulletin.]

* * * * *

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on May 20, 2004, 8:45 a.m., and published in the issue of the Federal Register for May 19, 2004, 69 F.R. 29113)

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Suspensions, Censures, Disbarments, and Resignations

Announcement 2004-49

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Consent Disbarments From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to disbarment from such practice. The Director, Office of Professional Responsibility, in his discretion, may disbar an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent disbarment from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
Ranes III, Wesse C.	Annapolis, MD	CPA	Indefinite from May 1, 2004

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Montgomery, Goldie L.	Lancaster, CA	Enrolled Agent	Indefinite from February 1, 2004
Frost, Charles L.	San Antonio, TX	Enrolled Agent	Indefinite from February 1, 2004
Briggs, John W.	Sayville, NY	Enrolled Agent	February 10, 2004 from August 8, 2004
Lahman, Gary M.	Ft. Collins, CO	Enrolled Agent	Indefinite from February 12, 2004
Stanny, Gertrude M.	South Lyon, MI	Enrolled Agent	Indefinite from March 1, 2004
Millar, Mark	Tall Timbers, MD	Enrolled Agent	Indefinite from March 1, 2004
Murray, Maureen E.	Naugatuck, CT	Enrolled Agent	Indefinite from March 1, 2004
Keith, James S.	Imperial Beach, CA	Enrolled Agent	March 2, 2004 from June 30, 2004
Zelek, Linda S.	Moultonboro, NH	CPA	Indefinite from March 4, 2004
Gilpin, Charles H.	San Leandro, CA	Enrolled Agent	Indefinite from March 5, 2004
Smith, Sean M.	Silver Spring, MD	Enrolled Agent	Indefinite from March 15, 2004
Morelini, Wayne C.	Modesto, CA	Enrolled Agent	Indefinite from March 15, 2004
Bower, Jay	Redmond, OR	Enrolled Agent	Indefinite from March 16, 2004
Lynn, Celia M.	Locust Grove, VA	Enrolled Agent	Indefinite from April 1, 2004

Name	Address	Designation	Date of Suspension
Swantz Jr., H. E.	San Diego, CA	Enrolled Agent	Indefinite from April 6, 2004
Hart, David A.	Lake Zurich, IL	Enrolled Agent	Indefinite from April 8, 2004
Lau, Dennis K.M.	Honolulu, HI	Enrolled Agent	Indefinite from April 20, 2004
Lentz, Carole	Mastic, NY	Enrolled Agent	Indefinite from April 23, 2004
Goble, Dennis R.	Valparaiso, IN	CPA	Indefinite from April 26, 2004
Rivera, Eduardo M.	Torrence, CA	Attorney	May 1, 2004 to October 29, 2006
Grant, Elaine C.	Woodway, WA	Enrolled Agent	May 1, 2004 to October 31, 2004
Bell, Don	Grand Junction, CO	Enrolled Agent	Indefinite from May 1, 2004
Cohick, Jeffrey S.	Newville, PA	Enrolled Agent	May 1, 2004 from October 30, 2004

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Candelario, Alexander	Cabins, WV	CPA	Indefinite from February 1, 2004
Riener, Richard	St. Paul, MN	Attorney	Indefinite from March 1, 2004

Name	Address	Designation	Date of Suspension
Dunkle, Clark	Carlisle, PA	CPA	Indefinite from March 15, 2004
Bailey, Donald D.	Tucson, AZ	CPA	Indefinite from March 18, 2004
Hill, Donald R.	Clinchco, VA	CPA	Indefinite from April 1, 2004
Bergeson, Nancy	Inver Grove Hghts, MN	CPA	Indefinite from April 14, 2004
Reese, Kenneth J.	Nebraska City, NE	CPA	Indefinite from April 15, 2004
Coates, Marsden S.	Baltimore, MD	Attorney	Indefinite from April 15, 2004
Schaefer, Robert J.	Moorhead, MN	Attorney	Indefinite from April 20, 2004
Mills, Stuart B.	Pender, NE	Attorney	Indefinite from May 1, 2004
Harris-Smith, Bridgette	Silver Spring, MD	Attorney	Indefinite from May 3, 2004
Janousek, Donald R.	Omaha, NE	Attorney	Indefinite from May 3, 2004
Williams, Gary W.	Diamond Bar, CA	CPA	Indefinite from May 3, 2004
Demaio, Louis J.	Bel Air, MD	Attorney	Indefinite from May 3, 2004
Miller, Frederick C.	Cedar Hill, TX	CPA	Indefinite from May 15, 2004

Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent, or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand.

The following individuals have consented to the issuance of a Censure:

Name	Address	Designation	Date of Censure
Friedman, Milton G.	Ft. Lauderdale, FL	CPA	December 30, 2003
Stevens, William E.	Omaha, NE	CPA	February 13, 2004
Turner, Mark A.	Cincinnati, OH	CPA	February 25, 2004
Rath, Dorris A.	Bradenton, FL	Enrolled Agent	March 9, 2004
Damiano, Lisa	South Windsor, CT	Enrolled Agent	March 9, 2004
Silbiger, Arnold R.	Baltimore, MD	Attorney	March 11, 2004
Farwell, Nancy K.	Citrus Heights, CA	Enrolled Agent	April 5, 2004
Dembrowski, Karen E.	Encino, CA	CPA	April 13, 2004

Correction Under Rev. Rul. 2004–57

Announcement 2004–52

Rev. Rul. 2004–57, page 1048 this Bulletin, provides that an eligible governmental plan under § 457(b) of the Internal Revenue Code must be established and maintained by an eligible employer as defined under § 457(e)(1)(A). A plan established before June 14, 2004, that does not satisfy the requirements of the revenue ruling solely as a result of being established and maintained by a labor organization instead of being established and maintained by an eligible governmental employer may nonetheless be treated as established and maintained by an eligible governmental employer if:

(1) contributions to the plan cease with respect to payroll periods that begin after December 31, 2004, and

(2) either of the following corrective actions is completed by December 31, 2005:

(a) The eligible employer as defined under § 457(e)(1)(A) adopts the plan, or

(b) The accounts of the employees under the plan are transferred (not rolled over) into an eligible governmental plan maintained by the eligible employer as defined under § 457(e)(1)(A) in accordance with the requirements of § 1.457–10(b)(4) of the Income Tax Regulations. For this limited purpose, the transferor plan will be treated as an eligible governmental plan of the same employer.

Even if such correction is made, however, the plan will not be treated as an eligible governmental plan under § 457(b) unless it also satisfies all of the requirements for such plans under § 457 and the regulations thereunder (other than the requirement that the plan be established and maintained by an eligible employer with respect to periods before December 31, 2005).

If the corrective actions described above fail to be completed by December 31, 2005, the plan will be treated as an ineligible deferred compensation arrangement that is subject to § 457(f) of the Code. Under § 457(f), benefits may be currently includible in income even if they are not currently available to the participants under the terms of the plan. Likewise, if the plan is liquidated before December 31, 2005, without corrective action as described above, distributions from the plan will be taxed in accordance with § 457(f). A funded plan solely established by a labor organization after June 14, 2004, that does not satisfy the requirements of Rev. Rul. 2004–57 will be treated as an arrangement subject to § 457(f).

For further information, please call the Employee Plans' taxpayer assistance telephone service at 1 (877) 829–5500 (a toll-free call) between the hours of 8:00 AM and 6:30 PM Eastern time, Monday through Friday.

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

Numerical Finding List[1]

Bulletins 2004–1 through 2004–24

Announcements:

2004-1, 2004-1 I.R.B. *254*
2004-2, 2004-3 I.R.B. *322*
2004-3, 2004-2 I.R.B. *294*
2004-4, 2004-4 I.R.B. *357*
2004-5, 2004-4 I.R.B. *362*
2004-6, 2004-3 I.R.B. *322*
2004-7, 2004-4 I.R.B. *365*
2004-8, 2004-6 I.R.B. *441*
2004-9, 2004-6 I.R.B. *441*
2004-10, 2004-7 I.R.B. *501*
2004-11, 2004-10 I.R.B. *581*
2004-12, 2004-9 I.R.B. *541*
2004-13, 2004-9 I.R.B. *543*
2004-14, 2004-10 I.R.B. *582*
2004-15, 2004-11 I.R.B. *612*
2004-16, 2004-13 I.R.B. *668*
2004-17, 2004-12 I.R.B. *635*
2004-18, 2004-12 I.R.B. *639*
2004-19, 2004-13 I.R.B. *668*
2004-20, 2004-13 I.R.B. *673*
2004-21, 2004-13 I.R.B. *673*
2004-22, 2004-14 I.R.B. *709*
2004-23, 2004-13 I.R.B. *673*
2004-24, 2004-14 I.R.B. *714*
2004-25, 2004-15 I.R.B. *737*
2004-26, 2004-15 I.R.B. *743*
2004-27, 2004-14 I.R.B. *714*
2004-28, 2004-16 I.R.B. *818*
2004-29, 2004-15 I.R.B. *772*
2004-30, 2004-17 I.R.B. *833*
2004-31, 2004-18 I.R.B. *854*
2004-32, 2004-18 I.R.B. *860*
2004-33, 2004-18 I.R.B. *862*
2004-34, 2004-19 I.R.B. *895*
2004-35, 2004-17 I.R.B. *839*
2004-36, 2004-20 I.R.B. *932*
2004-37, 2004-17 I.R.B. *839*
2004-38, 2004-18 I.R.B. *878*
2004-39, 2004-17 I.R.B. *840*
2004-40, 2004-17 I.R.B. *840*
2004-41, 2004-18 I.R.B. *879*
2004-42, 2004-17 I.R.B. *840*
2004-43, 2004-21 I.R.B. *955*
2004-44, 2004-21 I.R.B. *957*
2004-45, 2004-21 I.R.B. *958*
2004-46, 2004-21 I.R.B. *964*
2004-47, 2004-21 I.R.B. *966*
2004-48, 2004-22 I.R.B. *998*
2004-49, 2004-20 I.R.B. *966*
2004-50, 2004-22 I.R.B. *1005*
2004-51, 2004-23 I.R.B. *1041*
2004-52, 2004-24 I.R.B. *1071*

Announcements— Continued:

2004-54, 2004-24 I.R.B. *1061*

Court Decisions:

2078, 2004-16 I.R.B. *773*
2079, 2004-22 I.R.B. *978*

Notices:

2004-1, 2004-2 I.R.B. *268*
2004-2, 2004-2 I.R.B. *269*
2004-3, 2004-5 I.R.B. *391*
2004-4, 2004-2 I.R.B. *273*
2004-5, 2004-7 I.R.B. *489*
2004-6, 2004-3 I.R.B. *308*
2004-7, 2004-3 I.R.B. *310*
2004-8, 2004-4 I.R.B. *333*
2004-9, 2004-4 I.R.B. *334*
2004-10, 2004-6 I.R.B. *433*
2004-11, 2004-6 I.R.B. *434*
2004-12, 2004-10 I.R.B. *556*
2004-13, 2004-12 I.R.B. *631*
2004-14, 2004-9 I.R.B. *526*
2004-15, 2004-9 I.R.B. *526*
2004-16, 2004-9 I.R.B. *527*
2004-17, 2004-11 I.R.B. *605*
2004-18, 2004-11 I.R.B. *605*
2004-19, 2004-11 I.R.B. *606*
2004-20, 2004-11 I.R.B. *608*
2004-21, 2004-11 I.R.B. *609*
2004-22, 2004-12 I.R.B. *632*
2004-23, 2004-15 I.R.B. *725*
2004-24, 2004-13 I.R.B. *642*
2004-25, 2004-15 I.R.B. *727*
2004-26, 2004-16 I.R.B. *782*
2004-27, 2004-16 I.R.B. *782*
2004-28, 2004-16 I.R.B. *783*
2004-29, 2004-17 I.R.B. *828*
2004-30, 2004-17 I.R.B. *828*
2004-31, 2004-17 I.R.B. *830*
2004-32, 2004-18 I.R.B. *847*
2004-33, 2004-18 I.R.B. *847*
2004-34, 2004-18 I.R.B. *848*
2004-35, 2004-19 I.R.B. *889*
2004-36, 2004-19 I.R.B. *889*
2004-37, 2004-21 I.R.B. *947*
2004-38, 2004-21 I.R.B. *949*
2004-39, 2004-22 I.R.B. *982*
2004-40, 2004-23 I.R.B. *1028*

Proposed Regulations:

REG-106590-00, 2004-14 I.R.B. *704*
REG-116664-01, 2004-3 I.R.B. *319*
REG-129447-01, 2004-19 I.R.B. *894*
REG-106681-02, 2004-18 I.R.B. *852*
REG-122379-02, 2004-5 I.R.B. *392*

Proposed Regulations— Continued:

REG-139792-02, 2004-20 I.R.B. *926*
REG-139845-02, 2004-5 I.R.B. *397*
REG-140492-02, 2004-23 I.R.B. *1031*
REG-148399–02, 2004-24 I.R.B. *1066*
REG-165579-02, 2004-13 I.R.B. *651*
REG-166012-02, 2004-13 I.R.B. *655*
REG-115471-03, 2004-14 I.R.B. *706*
REG-116564-03, 2004-20 I.R.B. *927*
REG-121475-03, 2004-16 I.R.B. *793*
REG-126459-03, 2004-6 I.R.B. *437*
REG-126967-03, 2004-10 I.R.B. *566*
REG-128309-03, 2004-16 I.R.B. *800*
REG-128590-03, 2004-21 I.R.B. *952*
REG-149752-03, 2004-14 I.R.B. *707*
REG-153172-03, 2004-15 I.R.B. *729*
REG-156232-03, 2004-5 I.R.B. *399*
REG-156421-03, 2004-10 I.R.B. *571*
REG-167217-03, 2004-9 I.R.B. *540*
REG-167265-03, 2004-15 I.R.B. *730*

Revenue Procedures:

2004-1, 2004-1 I.R.B. *1*
2004-2, 2004-1 I.R.B. *83*
2004-3, 2004-1 I.R.B. *114*
2004-4, 2004-1 I.R.B. *125*
2004-5, 2004-1 I.R.B. *167*
2004-6, 2004-1 I.R.B. *197*
2004-7, 2004-1 I.R.B. *237*
2004-8, 2004-1 I.R.B. *240*
2004-9, 2004-2 I.R.B. *275*
2004-10, 2004-2 I.R.B. *288*
2004-11, 2004-3 I.R.B. *311*
2004-12, 2004-9 I.R.B. *528*
2004-13, 2004-4 I.R.B. *335*
2004-14, 2004-7 I.R.B. *489*
2004-15, 2004-7 I.R.B. *490*
2004-16, 2004-10 I.R.B. *559*
2004-17, 2004-10 I.R.B. *562*
2004-18, 2004-9 I.R.B. *529*
2004-19, 2004-10 I.R.B. *563*
2004-20, 2004-13 I.R.B. *642*
2004-21, 2004-14 I.R.B. *702*
2004-22, 2004-15 I.R.B. *727*
2004-23, 2004-16 I.R.B. *785*
2004-24, 2004-16 I.R.B. *790*
2004-25, 2004-16 I.R.B. *791*
2004-26, 2004-19 I.R.B. *890*
2004-27, 2004-17 I.R.B. *831*
2004-28, 2004-22 I.R.B. *984*
2004-29, 2004-20 I.R.B. *918*
2004-30, 2004-21 I.R.B. *950*
2004-31, 2004-22 I.R.B. *986*
2004-32, 2004-22 I.R.B. *988*
2004-33, 2004-22 I.R.B. *989*
2004-34, 2004-22 I.R.B. *991*

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2003–27 through 2003–52 is in Internal Revenue Bulletin 2003–52, dated December 29, 2003.

Revenue Procedures— Continued:

Revenue Rulings:

Revenue Rulings— Continued:

Tax Conventions:

Treasury Decisions:

Findings List of Current Actions on Previously Published Items[1]

Bulletins 2004–1 through 2004–24

Announcements:

93-60
Obsoleted by
Rev. Proc. 2004-23, 2004-16 I.R.B. *785*

2003-56
Modified by
Ann. 2004-11, 2004-10 I.R.B. *581*

2004-38
Modified by
Ann. 2004-43, 2004-21 I.R.B. *955*

2004-43
Corrected by
Ann. 2004-51, 2004-23 I.R.B. *1041*

Notices:

98-5
Withdrawn by
Notice 2004-19, 2004-11 I.R.B. *606*

2000-4
Obsoleted by
T.D. 9115, 2004-14 I.R.B. *680*

2002-31
Modified by
Rev. Rul. 2004-60, 2004-24 I.R.B. *1051*

2003-76
Modified by
Notice 2004-19, 2004-11 I.R.B. *606*

2004–2
Modified by
Notice 2004–25, 2004–15 I.R.B. *727*

Proposed Regulations:

REG-110896-98
Corrected by
Ann. 2004-14, 2004-10 I.R.B. *582*

REG-115037-00
Corrected by
Ann. 2004-7, 2004-4 I.R.B. *365*

REG-138499-02
Partially withdrawn by
REG-106590-00, 2004-14 I.R.B. *704*

REG-143321-02
Withdrawn by
REG-156232-03, 2004-5 I.R.B. *399*

REG-146893-02
Corrected by
Ann. 2004-7, 2004-4 I.R.B. *365*

Proposed Regulations— Continued:

REG-163974-02
Corrected by
Ann. 2004-13, 2004-9 I.R.B. *543*

REG-166012-02
Corrected by
Ann. 2004-40, 2004-17 I.R.B. *840*

Revenue Procedures:

71-21
Modified and superseded by
Rev. Proc. 2004-34, 2004-22 I.R.B. *991*

85-35
Obsoleted by
Rev. Proc. 2004-26, 2004-19 I.R.B. *890*

87-19
Obsoleted in part by
Rev. Proc. 2004-18, 2004-9 I.R.B. *529*

93-15
Obsoleted in part by
Rev. Proc. 2004-18, 2004-9 I.R.B. *529*

94-41
Superseded by
Rev. Proc. 2004-15, 2004-7 I.R.B. *490*

94-55
Obsoleted in part by
Rev. Proc. 2004-18, 2004-9 I.R.B. *529*

98-16
Suspended by
Notice 2004-12, 2004-10 I.R.B. *556*

2000-38
Modified by
Rev. Proc. 2004-11, 2004-3 I.R.B. *311*

2000-50
Modified by
Rev. Proc. 2004-11, 2004-3 I.R.B. *311*

2001-10
Modified by
Ann. 2004-16, 2004-13 I.R.B. *668*

2001-23
Modified by
Ann. 2004-16, 2004-13 I.R.B. *668*

2002-9
Modified and amplified by
Rev. Rul. 2004-18, 2004-8 I.R.B. *509*
Rev. Proc. 2004-23, 2004-16 I.R.B. *785*
Rev. Proc. 2004-30, 2004-21 I.R.B. *950*
Rev. Proc. 2004-32, 2004-22 I.R.B. *988*
Rev. Proc. 2004-33, 2004-22 I.R.B. *989*
Rev. Proc. 2004-34, 2004-22 I.R.B. *991*
Rev. Proc. 2004-36, 2004-24 I.R.B. *1063*
Modified by
Rev. Proc. 2004-11, 2004-3 I.R.B. *311*

Revenue Procedures— Continued:

Ann. 2004-16, 2004-13 I.R.B. *668*

2002-28
Modified by
Ann. 2004-16, 2004-13 I.R.B. *668*

2002-71
Superseded by
Rev. Proc. 2004-13, 2004-4 I.R.B. *335*

2003-1
Superseded by
Rev. Proc. 2004-1, 2004-1 I.R.B. *1*

2003-2
Superseded by
Rev. Proc. 2004-2, 2004-1 I.R.B. *83*

2003-3
As amplified by Rev. Proc. 2003-14, and as modified by Rev. Proc. 2003-48 superseded by
Rev. Proc. 2004-3, 2004-1 I.R.B. *114*

2003-4
Superseded by
Rev. Proc. 2004-4, 2004-1 I.R.B. *125*

2003-5
Superseded by
Rev. Proc. 2004-5, 2004-1 I.R.B. *167*

2003-6
Superseded by
Rev. Proc. 2004-6, 2004-1 I.R.B. *197*

2003-7
Superseded by
Rev. Proc. 2004-7, 2004-1 I.R.B. *237*

2003-8
Superseded by
Rev. Proc. 2004-8, 2004-1 I.R.B. *240*

2003-23
Modified and superseded by
Rev. Proc. 2004-14, 2004-7 I.R.B. *489*

2003-26
Supplemented by
Rev. Proc. 2004-17, 2004-10 I.R.B. *562*

2003-29
Obsoleted, except as provided in section 5.02, by
Rev. Proc. 2004-24, 2004-16 I.R.B. *790*

2003-64
Modified by
Rev. Proc. 2004-21, 2004-14 I.R.B. *702*

2004-1
Corrected by
Ann. 2004-8, 2004-6 I.R.B. *441*

[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2003–27 through 2003–52 is in Internal Revenue Bulletin 2003–52, dated December 29, 2003.

Revenue Procedures— Continued:

2004-4

Modified by

Rev. Proc. 2004-15, 2004-7 I.R.B. *490*

2004-5

Modified by

Rev. Proc. 2004-15, 2004-7 I.R.B. *490*

2004-6

Modified by

Rev. Proc. 2004-15, 2004-7 I.R.B. *490*

Revenue Rulings:

55-748

Modified and superseded by

Rev. Rul. 2004-20, 2004-10 I.R.B. *546*

92-19

Supplemented in part by

Rev. Rul. 2004-14, 2004-8 I.R.B. *511*

94-38

Clarified by

Rev. Rul. 2004-18, 2004-8 I.R.B. *509*

98-25

Clarified by

Rev. Rul. 2004-18, 2004-8 I.R.B. *509*

2004-38

Modified by

Rev. Proc. 2004-22, 2004-15 I.R.B. *727*

Treasury Decisions:

9088

Corrected by

Ann. 2004-39, 2004-17 I.R.B. *840*

*U.S. Government Printing Office: 2004—304–778/60139